No. 14-163

Title:	Bank of America, N.A., Petitioner v. Edelmiro Toledo-Cardona
Docketed:	August 13, 2014
Lower Ct:	United States Court of Appeals for the Eleventh Circuit
Case Nos.:	(13-15855)
Decision Date:	May 15, 2014

Questions Presented

--Date--	------Proceedings and Orders----------
Aug 13 2014	Petition for a writ of certioran filed. (Response due September 12, 2014)
Aug 25 2014	Order extending time to file response to petition to and including October 14, 2014.
Oct 6 2014	Brief of respondent Edelmiro Toledo-Cardona in opposition filed.
Oct 21 2014	Reply of petitioner Bank of America, N.A. filed.
Oct 22 2014	DISTRIBUTED for Conference of November 7, 2014.
Nov 10 2014	DISTRIBUTED for Conference of November 14, 2014.
Nov 17 2014	Petition GRANTED The petition for a writ of certiorari in No. 13-1421 is granted. The cases are consolidated and a total of one hour is allotted for oral argument.
Nov 18 2014	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from respondents David Caulkett, and Elmiro Toledo-Cardona. VIDED
Nov 21 2014	The time to file the joint appendix and petitioner's brief on the merits is extended to and including January 9, 2015. VIDED
Nov 21 2014	The time to file respondents' brief(s) on the merits is extended to and including February 17, 2015. VIDED
Dec 4 2014	Motion to dispense with printing the joint appendix filed by petitioner Bank of America, N.A. VIDED.
Dec 15 2014	Motion to dispense with printing the joint appendix filed by petitioner GRANTED. VIDED
Jan 9 2015	Brief of petitioner Bank of America, N.A. filed. VIDED.
Jan 16 2015	Brief amici curiae of Loan Syndications and Trading Association, et al filed. VIDED.
Jan 16 2015	Brief amicus curiae of Community Bankers Association of Illinois filed. VIDED.
Feb 2 2015	SET FOR ARGUMENT ON Tuesday, March 24, 2015. VIDED
Feb 3 2015	Record requested from U.S.C.A. 11th Circuit.
Feb 12 2015	CIRCULATED
Feb 17 2015	Brief of respondent David B. Caulkett filed. VIDED. (Distributed)
Feb 19 2015	Brief amici curiae of Professors Jagdeep S. Bhandari, et al. filed. VIDED. (Distributed)
Feb 23 2015	Brief amici curiae of National Association of Consumer Bankruptcy Attorneys and AARP filed. VIDED. (Distributed)
Feb 23 2015	Brief amicus curiae of Adam J. Levitin, Professor of Law filed. VIDED. (Distributed)

Feb 24 2015	Brief amici curiae of Jerome N. Frank Legal Services Organization, et al. filed. VIDED. (Distributed)
Feb 24 2015	Brief amicus curiae of NYU Law School Bankruptcy Appellate Clinic filed. VIDED. (Distributed)
Feb 24 2015	Brief amici curiae of Bankruptcy Law Professors Robert M. Lawless, et al. filed. VIDED. (Distributed)
Feb 24 2015	Brief amicus curiae of Professor Margaret Howard filed. VIDED. (Distributed)
Feb 24 2015	Brief amicus curiae of Occupy the SEC filed. VIDED. (Distributed)
Mar 16 2015	Reply of petitioner Bank of America, N.A. filed. VIDED. (Distributed)
Mar 24 2015	Argued. For petitioner: Danielle Spinelli, Washington, D. C. For respondents: Stephanos Bibas, Philadelphia, Pa.
Jun 1 2015	Judgment REVERSED and case REMANDED. Thomas, J., delivered the opinion of the Court, in which Roberts, C. J., and Scalia, Ginsburg, Alito, and Kagan, JJ., joined, and in which Kennedy, Breyer, and Sotomayor, JJ., joined except as to the footnote. VIDED.
Jul 6 2015	JUDGMENT ISSUED.

Supreme Court, U.S.
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No. 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 506(d) of the Bankruptcy Code provides in relevant part that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court held that section 506(d) does not permit a chapter 7 debtor to "strip down" a mortgage lien to the current value of the collateral. The question presented in this case, on which the courts of appeals are divided, is whether section 506(d) permits a chapter 7 debtor to "strip off" a junior mortgage lien in its entirety when the outstanding debt owed to a senior lienholder exceeds the current value of the collateral.

PARTIES TO THE PROCEEDINGS

Petitioner Bank of America, N.A. was the respondent in the bankruptcy court and the appellant in the district court and court of appeals.

Respondent Edelmiro Toledo-Cardona, the debtor in the bankruptcy case, was the movant in the bankruptcy court and the appellee in the district court and court of appeals.

CORPORATE DISCLOSURE STATEMENT

Petitioner Bank of America, N.A. is a wholly-owned subsidiary of Bank of America Corporation, a publicly traded corporation (ticker symbol: BAC). Bank of America Corporation has no parent corporation, and no publicly held corporation holds 10% or more of its stock.

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IN THE

Supreme Court of the United States

No. 14-

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Petitioner Bank of America, N.A. respectfully petitions for a writ of certiorari to review the judgment of the U.S. Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The court of appeals' order affirming the district court is unpublished and appears at App. 1a-3a. The district court's order affirming the bankruptcy court is unpublished and appears at App. 5a-6a. The bankruptcy court's order granting respondent's motion to strip off Bank of America's junior lien on his house is unpublished and appears at App. 7a-9a. The Eleventh Circuit's decision in *McNeal* v. *GMAC Mortgage, LLC*, the basis for the holding in this case, is reported at 735

F.3d 1263. App. 11a-15a. On May 20, 2014, the Eleventh Circuit denied GMAC's petition to rehear *McNeal* en banc. App. 17a-18a.

JURISDICTION

The Eleventh Circuit entered its order affirming the district court on May 15, 2014. App. 1a-3a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 506 of the Bankruptcy Code provides in relevant part:

> (a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.
>
> ...
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> > (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
> >
> > (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506.

STATEMENT

This case is identical in substance to *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, which is already awaiting this Court's review. Like *Caulkett*, it presents a square circuit split on an important and frequently recurring question of bankruptcy law: Whether a chapter 7 debtor may "strip off"—that is, void—a valid junior lien on the debtor's house when the debt owed to a senior lienholder exceeds the house's current value. In *McNeal* v. *GMAC Mortgage, LLC*, 735 F.3d 1263 (2012), *reh'g denied* (11th Cir. 2014), the Eleventh Circuit held that a debtor may strip off such a junior lien. That conclusion disregarded the holding and reasoning of this Court's decision in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), and expressly rejected decisions from the Fourth, Sixth, and Seventh Circuits.

Despite pleas to reconsider, the Eleventh Circuit has continued to apply its flawed minority position to case after case—including this one, where it held that Bank of America's junior lien securing the loan it made to the respondent, Edelmiro Toledo-Cardona, could be stripped off in his chapter 7 bankruptcy case solely because at the time of the bankruptcy the lien was "wholly underwater." App. 2a. Indeed, since denying rehearing in *McNeal*, the Eleventh Circuit has twice refused to rehear this issue en banc, *see* Order, *Bank of Am., N.A.* v. *Bello*, No. 14-10062 (June 17, 2014); Order, *Wilmington Trust, N.A.* v. *Malone*, No. 13-13688 (July 16, 2014), leaving no doubt that the circuit split cannot and will not be resolved absent this Court's intervention.

In order to address this issue of central importance to the administration of chapter 7 cases and to restore uniform treatment of home mortgages in bankruptcy,

the petition in *Caulkett* should be granted and the petition in this case held pending *Caulkett*'s disposition. In the alternative, the Court should grant this petition.

1. Chapter 7 of the Bankruptcy Code permits eligible individual debtors to obtain "a discharge of prepetition debts following the liquidation of the debtor's [non-exempt] assets by a bankruptcy trustee, who then distributes the proceeds to creditors." *Marrama* v. *Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007); *see also* 11 U.S.C. §§ 524, 704, 727. Importantly, however, a chapter 7 proceeding discharges only the debtor's *personal* liability on his debts; it does not typically void a secured creditor's right to foreclose on the property securing the creditor's claim. 11 U.S.C. § 524(a)(1), (2) (providing that a discharge voids certain judgments and enjoins certain collection proceedings regarding debts that are the "personal liability of the debtor"); *see also, e.g.*, *Dewsnup*, 502 U.S. at 417 ("[T]he creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee.").

Many chapter 7 debtors have no equity in their houses because the houses are worth less than the amount outstanding on the mortgage loans they secure—that is, the loans are undersecured or "underwater." In such cases, rather than selling the house, the chapter 7 trustee may "abandon" it to the debtor as being "of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a), (b). If the debtor is in default on the mortgage and lacks the means to cure the default, he or she may surrender the house to the mortgage-holder in satisfaction of its secured claim, and any deficiency claim the mortgage-holder may have against the debtor is discharged. Alternatively, if the debtor is current on the mortgage, he or she may stay in the house and con-

tinue to pay the mortgage following the chapter 7 proceeding. In that scenario, too, any personal liability the debtor may have under the terms of the mortgage loan is discharged. In short, as this Court has explained, "the mortgage interest that passes through a Chapter 7 liquidation is enforceable only against the debtor's property" and "has the same properties as a nonrecourse loan." *Johnson* v. *Home State Bank*, 501 U.S. 78, 86 (1991).

This case presents the question whether, when a first mortgage on a chapter 7 debtor's house is undersecured, so that a second mortgage is completely "underwater," the debtor may not only discharge his or her personal liability for the second mortgage loan, but also "strip off" the lien itself, leaving the mortgage-holder without the right to foreclose on the property even if the value of the property subsequently increases. The answer to that question turns on the construction of section 506 of the Bankruptcy Code, which governs the treatment of undersecured claims.

Section 506(a) provides, as relevant here, that "[a]n allowed claim of a creditor secured by a lien on [estate] property ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim." 11 U.S.C. § 506(a). In essence, section 506(a) bifurcates a creditor's undersecured claim into a "secured claim" for the present value of the collateral and an "unsecured claim" for the remainder. Thus, a senior mortgage lender owed $150,000 on a loan secured by a house worth $100,000 would have a secured claim for $100,000 and an unsecured claim for $50,000, while a junior lender

owed $25,000 on a loan secured by the same house would have only an unsecured claim for $25,000.

Section 506(d), the key provision at issue in this case, in turn provides—subject to exceptions not relevant here—that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d).

Before this Court's decision in *Dewsnup*, some courts, including the Eleventh Circuit, had held that section 506(d) permitted a debtor to strip a secured creditor's lien down to the value of the collateral securing the creditor's claim. *See, e.g., Folendore* v. *Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989). In *Folendore*, the creditor held a junior mortgage on the debtors' property. The creditor's claim was conceded to be valid and had been allowed. *Id.* at 1538. But its lien was completely underwater because the property's value was less than the outstanding debt on the two senior mortgage loans. *Id.* The Eleventh Circuit reasoned that because section 506(a) treats the portion of a secured claim in excess of the value of the security as unsecured, the creditor had no "allowed secured claim" within the meaning of section 506(d), and its lien could thus be stripped off. *Id.* at 1539.

2. In 1992, however, this Court decided *Dewsnup*, which decisively rejected that construction of section 506. In *Dewsnup*, the creditor had issued a pre-bankruptcy loan to the debtor secured by a lien on the debtor's real property. When the debtor filed for bankruptcy, the lien was partially underwater because the outstanding balance on the loan exceeded the then-current value of the property. The debtor moved, pursuant to section 506(d), to void the portion of the lien that was underwater, making the same statutory ar-

gument that the Eleventh Circuit had accepted in *Folendore*. That is, the debtor "t[ook] the position that §§ 506(a) and 506(d) are complementary and to be read together. Because, under § 506(a), a claim is secured only to the extent of the judicially determined value of the real property on which the lien is fixed, a debtor can void a lien on the property pursuant to § 506(d) to the extent the claim is no longer secured and thus is not 'an allowed secured claim.'" *Dewsnup*, 502 U.S. at 414. In support of this position, the debtor expressly relied on *Folendore*, noting that the Eleventh Circuit had "flatly rejected" the view that section 506(d) does not authorize lien-stripping. *See* Reply Br. 13, *Dewsnup*, No. 90-741 (U.S. July 26, 1991).

This Court rejected the debtor's reading of the statute—and, by extension, the Eleventh Circuit's reading—and held that section 506(d) does not permit a debtor to void a lien securing an allowed claim. Adopting the statutory construction advocated by the United States, the Court reasoned that "the words 'allowed secured claim' in § 506(d) need not be read as an indivisible term of art defined by reference to § 506(a)." *Dewsnup*, 502 U.S. at 415. "Rather, the words should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Id.* Where a claim "has been 'allowed' ... and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of § 506(d)." *Id.* That construction, the Court explained, gives section 506(d) "the simple and sensible function of voiding a lien whenever a claim secured by the lien itself has not been allowed" and "ensures that the Code's determination not to allow the underlying claim against the debtor personally is given full effect by preventing its assertion against the debtor's property." *Id.* at 415-416.

In reaching that conclusion, this Court emphasized the fundamental and longstanding principle that "liens pass through bankruptcy unaffected." *Dewsnup*, 502 U.S. at 417. As the Court explained, under well-established practice prior to the 1978 enactment of the Bankruptcy Code, "involuntary reduction of the amount of a creditor's lien" was not permitted "for any reason other than payment on the debt." *Id.* at 419. "Congress must have enacted [section 506(d)] with a full understanding of this practice." *Id.* Indeed, section 506(d)'s legislative history specified that the provision was intended to "permit[] liens to pass through the bankruptcy case unaffected." *Id.* (quoting H.R. Rep. No. 95-595, at 357 (1977)).

As this Court explained, the debtor's reading of the statute would have contradicted that basic principle. The "practical effect" of the debtor's approach would have been "to freeze the creditor's secured interest at the judicially determined valuation," depriving the creditor of "the benefit of any increase in the value of the property by the time of the foreclosure sale," and giving the debtor a potential "windfall." *Dewsnup*, 502 U.S. at 417. But, the Court recognized, the basic bargain of a mortgage requires that "the creditor's lien stays with the real property until the foreclosure," and any appreciation in the property's value "rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors." *Id.* Read against that backdrop, section 506 does not permit a debtor to strip a creditor's lien simply because it is undersecured in light of the current value of the collateral.

3. *Dewsnup* addressed what in bankruptcy jargon is called a "strip down"—that is, the creditor's mortgage was only partially, not completely, underwater.

Every court of appeals to address the issue, other than the Eleventh Circuit, has nonetheless correctly concluded that *Dewsnup*'s reasoning is equally applicable to "strip offs"—cases in which a mortgage is completely underwater, typically because a senior lienholder is undersecured. *See, e.g.*, *Ryan* v. *Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001); *In re Talbert*, 344 F.3d 555 (6th Cir. 2003); *Palomar* v. *First Am. Bank*, 722 F.3d 992 (7th Cir. 2013).

The Eleventh Circuit stands alone in holding that *Dewsnup*'s reasoning does not govern strip-offs. In *McNeal* v. *GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012), the Eleventh Circuit held that its pre-*Dewsnup* decision in *Folendore*, which permitted a chapter 7 debtor to strip off a wholly underwater mortgage, is still binding circuit precedent, notwithstanding *Dewsnup*. App. 14a-15a.

In *McNeal*, the Eleventh Circuit recognized that other courts of appeals had determined that *Dewsnup* precluded such a strip-off. App. 13a. It also acknowledged that *Dewsnup* "seems to reject the plain language analysis that we used in *Folendore*." *Id.* 14a. The court of appeals nonetheless concluded that, in light of its "prior panel precedent" rule (under which "a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is clearly on point"), "*Folendore*—not *Dewsnup*—controls in this case." *Id.* (internal quotation marks omitted). The Eleventh Circuit reasoned that *Dewsnup* was not "'clearly on point'" because it "disallowed only a 'strip down' of a partially secured mortgage lien and did not address a 'strip off' of a wholly unsecured lien." *Id.*

On May 20, 2014—almost two years after the lienholder's petition for rehearing was filed—the court refused to rehear the case en banc. App. 17a-18a.[1]

4. The debtor in this case, Edelmiro Toledo-Cardona, filed a chapter 7 petition in the U.S. Bankruptcy Court for the Middle District of Florida on April 25, 2013. Toledo-Cardona has two mortgages on his house, and the outstanding balance on the first mortgage exceeds the house's market value. He filed a motion to strip off Bank of America's junior lien under section 506(d).

In light of *McNeal*'s conclusion that *Folendore* remained good law, Bank of America conceded that its junior lien could be stripped off under then-binding precedent, but requested that the bankruptcy court stay the effectiveness of the order granting Toledo-Cardona's motion pending a final resolution of the issue by the en banc court of appeals or by this Court. The bankruptcy court denied that request and granted Toledo-Cardona's motion to strip off the junior lien. App. 7a-9a. Bank of America appealed to the district court, where—in light of *McNeal* and *Folendore*—the Bank moved for summary affirmance subject to the Bank's right to seek further appellate review. The district

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[1] This past March, the Court denied a petition for certiorari arising out of the Eleventh Circuit and raising the identical legal issue, *see Bank of America, N.A.* v. *Sinkfield*, 134 S. Ct. 1760 (2014), but at that time the petition for rehearing en banc in *McNeal* was still pending. Now that the court of appeals has denied that petition, App. 17a-18a, and has since denied rehearing en banc in two more cases presenting the same question, *see* Order, *Bank of Am., N.A.* v. *Bello*, No. 14-10062 (11th Cir. June 17, 2014); Order, *Wilmington Trust, N.A.* v. *Malone*, No. 13-13688 (11th Cir. July 16, 2014), any prudential considerations weighing against review of the issue have been eliminated.

court granted the motion and affirmed the bankruptcy court's decision. *Id.* 5a-6a.

Before the Eleventh Circuit, recognizing that it was futile to argue for overruling *Folendore* before a panel, Bank of America requested that the en banc court hear the matter. The court declined. On the same day, and just days before the court of appeals declined to rehear *McNeal* en banc, the panel issued a brief per curiam decision holding that it was "bound as a panel to follow our Court's decision in *McNeal*." App. 3a.

Since then, the Eleventh Circuit has continued to issue brief per curiam decisions applying the reasoning in *McNeal* and *Folendore*—and to deny petitions for rehearing those decisions en banc—making clear that the court has no intention of reconsidering its position.

REASONS FOR GRANTING THE WRIT

This case, like *Caulkett*, presents a critical issue of bankruptcy law affecting a large number of chapter 7 cases: Whether a wholly underwater lien can be "stripped off" under the authority of section 506(d). Under the logic of this Court's decision in *Dewsnup*, the answer should be no. And the Fourth, Sixth, and Seventh Circuits—all the courts of appeals to consider the question save the Eleventh Circuit—have so held. In the Eleventh Circuit, however, the answer is yes. And debtors' counsel have taken notice: Hundreds, likely thousands, of motions to strip off underwater second liens have been filed in Alabama, Florida, and Georgia since the Eleventh Circuit endorsed the practice two years ago in *McNeal*. And at this point there can be no doubt that the Eleventh Circuit will not solve the problem itself. This Court should intervene, clarify that

Dewsnup governs both "strip downs" and "strip offs," and restore uniformity to the administration of chapter 7 cases across the country.

I. THE ELEVENTH CIRCUIT'S POSITION IS IRRECONCILABLE WITH *DEWSNUP*

In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court squarely repudiated the interpretation of section 506(d) that the Eleventh Circuit had adopted in *Folendore* v. *Small Business Administration*, 862 F.2d 1537 (11th Cir. 1989), which held that section 506(d) permits a debtor to strip off a wholly underwater second lien. The Eleventh Circuit's resurrection of *Folendore* in *McNeal* v. *GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012), cannot be reconciled with *Dewsnup*.

As discussed above, *see supra* p. 6, *Folendore* had reasoned that because section 506(a) bifurcates undersecured claims into a secured claim for the value of the collateral and an unsecured claim for the remainder, a claim secured by a lien that is wholly underwater is not an "allowed secured claim" within the meaning of section 506(d), and the lien may therefore be stripped off. 862 F.2d at 1538-1539.

Dewsnup made clear, however, that *Folendore*'s reading of the phrase "allowed secured claim" was mistaken. As this Court explained in describing the argument made by the creditor and the United States—which the Court adopted, *see* 502 U.S. at 417—"the words 'allowed secured claim' in § 506(d) need not be read as an indivisible term of art defined by reference to § 506(a)," as *Folendore* had done, but instead "should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Id.* at 415. If a claim "has been 'allowed' ... and is secured by a lien with re-

course to the underlying collateral, it does not come within the scope of § 506(d)." *Id.* Read that way, section 506(d) has "the simple and sensible function of voiding a lien whenever a claim secured by the lien itself has not been allowed." *Id.* at 415-416.

Folendore therefore could not have survived *Dewsnup*. Indeed, in *McNeal*, the Eleventh Circuit acknowledged that *Dewsnup*'s reasoning "seems to reject" the "analysis that we used in *Folendore*." App. 14a. *McNeal* opined, however, that "[b]ecause *Dewsnup* disallowed only a 'strip down' of a partially secured mortgage lien and did not address a 'strip off' of a wholly unsecured lien, it is not 'clearly on point' with the facts in *Folendore*," and therefore *Folendore* remained binding in the Eleventh Circuit. *Id.* The Eleventh Circuit's order in this case in turn relied on *McNeal* as the basis for stripping Bank of America's lien. *Id.* 2a-3a.

Under the reasoning of *Dewsnup*, however, *McNeal*'s distinction between "strip downs" and "strip offs" is a distinction without a difference. *Dewsnup* interpreted section 506(d) to apply only "whenever a *claim* secured by the lien itself has not been allowed." 502 U.S. at 415 (emphasis added). In *Folendore*, *McNeal*, and this case, just as in *Dewsnup*, the creditor's *claim* was concededly valid: The debtor entered into a valid agreement with the mortgage-holder to borrow money, secured by a lien on the debtor's real property. Under *Dewsnup*'s logic, then, because Bank of America has a valid claim for the money it lent respondent, section 506(d) provides no basis for respondent to strip off Bank of America's lien.

To be sure, in *Folendore*, *McNeal*, and this case, just as in *Dewsnup*, the creditor's mortgage was un-

derwater because the total amount the debtor borrowed exceeded the value of the debtor's property when the debtor filed for bankruptcy. As *Dewsnup* made clear, however, that a mortgage is underwater matters only to the treatment of the creditor's *claim* under section 506(a)—the portion of the creditor's claim exceeding the value of the creditor's security interest is treated as unsecured. It has no effect on the treatment of the creditor's *lien* under section 506(d). Rather, consistent with well-established pre-Code practice, "liens pass through bankruptcy unaffected" unless the underlying claim is disallowed, and "[a]ny increase over the judicially determined valuation" of the collateral "during bankruptcy rightly accrues to the benefit of the creditor." *Dewsnup*, 502 U.S. at 417. As a logical matter, that is true regardless of whether, in light of the present value of the property, the lien is partially or wholly underwater. Had the Eleventh Circuit faithfully applied *Dewsnup*, it would have concluded that section 506(d), as this Court has interpreted it, does not permit respondent to strip off Bank of America's wholly underwater second lien.

II. The Eleventh Circuit's Position Conflicts With Rulings From The Fourth, Sixth, And Seventh Circuits

The Eleventh Circuit stands alone in refusing to apply *Dewsnup* in strip-off cases. The Fourth, Sixth, and Seventh Circuits—all of the other courts of appeals to consider the issue—have concluded that *Dewsnup*'s interpretation of section 506(d) bars a chapter 7 debtor from stripping off a wholly underwater lien securing a valid mortgage loan.

The Fourth Circuit so held in *Ryan* v. *Homecomings Financial Network*, 253 F.3d 778 (4th Cir. 2001).

The debtor in *Ryan* contended that the creditor's wholly underwater lien could be stripped off under section 506(d) because "*Dewsnup* controls only a 'strip down' of a partially secured lien, not a 'strip off' of a wholly unsecured lien." *Id.* at 781. The Fourth Circuit rejected that argument, explaining:

> "Whether the lien is wholly unsecured or merely undersecured, the reasons articulated by the Supreme Court for its holding in *Dewsnup*—that liens pass through bankruptcy unaffected, that mortgagee and mortgagor bargained for a consensual lien which would stay with real property until foreclosure, and that any increase in value of the real property should accrue to the benefit of the creditor, not the debtor or other unsecured creditors—are equally pertinent."

Id. at 783 (quoting *In re Laskin*, 222 B.R. 872, 876 (B.A.P. 9th Cir. 1998) (brackets omitted)). Concluding that "[t]he Court's reasoning in *Dewsnup* is equally relevant and convincing in a case like ours where a debtor attempts to strip off, rather than merely strip down, an approved but unsecured lien," the Fourth Circuit held that a debtor may not strip off a lien securing an allowed claim under section 506(d) even if the lien is wholly underwater. *Id.* at 782.

The Sixth Circuit subsequently reached the same conclusion, holding that *Dewsnup* "applies with equal force and logic" to strip-offs. *In re Talbert*, 344 F.3d 555, 556 (6th Cir. 2003). As in *Ryan*, the debtors in *Talbert* argued that "the secured status of a claim is determined by the security-reducing provision of § 506(a), and that pursuant to this provision, their junior lien is completely unsecured, and, thus, according to § 506(d),

may be 'stripped off.'" *Id.* at 558 (footnotes omitted). The Sixth Circuit noted that a "similar argument was rejected [by *Dewsnup*] in the analogous context of a debtor's attempt to 'strip down' an under-collateralized creditor's lien in a Chapter 7 case" and explained that *Dewsnup*'s reasoning "applie[d] with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off'":

> As in the case of a "strip down," to permit a "strip off" would mark a departure from the pre-Code rule that real property liens emerge from bankruptcy unaffected. Also, as in the case of a "strip down," a "strip off" would rob the mortgagee of the bargain it struck with the mortgagor, i.e., that the consensual lien would remain with the property until foreclosure. ... Finally, as was true in the context of "strip downs," Chapter 7 "strip offs" also carry the risk of a "windfall" to the debtors should the value of the encumbered property increase by the time of the foreclosure sale.

Id. at 561.

The Seventh Circuit recently reached the same conclusion in *Palomar* v. *First American Bank*, 722 F.3d 992 (7th Cir. 2013) (Posner, J.). The Seventh Circuit first explained that section 506(d) is "best interpreted as confirming the venerable principle ... that bankruptcy law permits a lien to pass through bankruptcy unaffected, provided that it's a valid lien and secures a valid claim." *Id.* at 993. It then concluded that *Dewsnup* defeated the debtor's attempt to strip off the creditor's wholly underwater lien: "*Dewsnup* ... holds that section 506(d) does not allow the bankruptcy court to squeeze down a fully valid lien to the current value of the property to which it's attached. That's the relief

the debtor in this case is seeking. The only difference between this case and *Dewsnup* is that our debtors want to reduce the value of the lien to zero"—a difference, the Seventh Circuit determined, that is immaterial in light of *Dewsnup*'s reasoning. *Id.* at 994 (citation omitted).[2]

The Fourth, Sixth, and Seventh Circuits are not alone. Every lower court outside the Eleventh Circuit to have addressed the issue of which Bank of America is aware has also held that *Dewsnup*'s reasoning forbids both strip-downs and strip-offs in chapter 7. *See, e.g.*, *Laskin*, 222 B.R. 872; *Wachovia Mortg.* v. *Smoot*, 478 B.R. 555 (E.D.N.Y. 2012); *In re Cook*, 449 B.R. 664 (D.N.J. 2011); *In re Richins*, 469 B.R. 375 (Bankr. D. Utah 2012); *In re Bowman*, 304 B.R. 166 (Bankr. M.D. Pa. 2003); *In re Fitzmaurice*, 248 B.R. 356 (Bankr. W.D. Mo. 2000). Like the Fourth, Sixth, and Seventh Circuits, these courts reject the superficial distinction between strip-offs and strip-downs. "Rather, what is controlling is the Supreme Court's construction of § 506(d)." *Wachovia Mortg.*, 478 B.R. at 568.[3]

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[2] Notably, *Palomar* was briefed and argued after *McNeal* was issued, and the debtor asked the Seventh Circuit to follow this Court's reasoning in *McNeal*. *See* Appellants' Br. 33, *Palomar*, No. 12-3492 (7th Cir. Dec. 10, 2012) ("Clearly, the courts that have chosen to extend the holding of *Dewsnup* did so although it was not warranted. As the Eleventh Circuit stated, '[o]bedience to a Supreme Court decision is one thing, extrapolating from its implications a holding on an issue that was not before that Court ... is another thing.'" (quoting *McNeal*, 735 F.3d at 1265-1266 (reprinted in App. 15a))). The Seventh Circuit declined to adopt *McNeal*'s reasoning.

[3] Although a handful of lower courts outside the Eleventh Circuit initially ruled that *Dewsnup* did not apply to strip-offs, those decisions have been overruled or reversed. *See, e.g.*, *In re Farha*,

III. This Case, Like Caulkett, Presents An Ideal Opportunity To Address A Question That Is Central To The Administration Of Chapter 7 Bankruptcies

The question presented here is of central importance to the administration of chapter 7 cases and to the treatment of home mortgages in particular. Following the housing crash, the decline in value of many houses across the country left many second mortgages completely underwater. While chapter 7 debtors can eliminate their personal liability for such mortgage loans through a discharge, until the Eleventh Circuit's decision in *McNeal*, it was settled law that a mortgageholder remained entitled to exercise its security interest in its collateral. As this Court put it, "the creditor's lien stays with the real property until foreclosure. That is what was bargained for by the mortgagor and the mortgagee." *Dewsnup*, 502 U.S. at 417.

As this case reflects, *McNeal* significantly altered the landscape in the Eleventh Circuit. As two local practitioners put it, "[t]he significance of *McNeal* can hardly be [over]stated, especially in this depressed real estate market," because "numerous properties subject to multiple mortgage liens are worth less than the amount of the first-priority mortgage." Bruce & Popowitz, *Get Busy Stripping Until The Eleventh Circuit Says Otherwise*, 2 S.D. Fla. Bankr. Bar Ass'n J. 1, 9 (2013).

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246 B.R. 547 (Bankr. E.D. Mich. 2000), *overruled by Talbert*, 344 F.3d 555; *In re Zempel*, 244 B.R. 625 (Bankr. W.D. Ky. 1999), *overruled by Talbert*, 344 F.3d 555; *In re Yi*, 219 B.R. 394 (E.D. Va. 1998), *overruled by Ryan*, 253 F.3d 778; *In re Smoot*, 465 B.R. 730 (Bankr. E.D.N.Y. 2011), *rev'd*, 478 B.R. 555 (E.D.N.Y. 2012).

Indeed, since *McNeal*, chapter 7 debtors have filed a flood of motions and complaints to strip off wholly underwater junior liens. In the Northern District of Georgia alone—which is where *McNeal* originated—debtors had filed more than 500 such motions by March 31, 2013. *See* Certification of Direct Appeal of Order 4, *In re Malone*, No. 12-61289, Dkt. 54 (Bankr. N.D. Ga. Apr. 25, 2013). And the flood has not abated one bit: In the Middle District of Florida, where Toledo-Cardona's case originates, 59 such motions—or about two per day—were docketed last month alone.[4] And Bank of America itself is currently litigating 67 other strip-off proceedings within the Eleventh Circuit, 15 of which were filed in the last two months.[5] What is more, in

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[4] Counsel for Bank of America reviewed all motions listed on PACER that were filed in June 2014 in the U.S. Bankruptcy Court for the Middle District of Florida.

[5] *Bank of Am., N.A.* v. *Belotserkovsky*, No. 14-11012 (11th Cir.); *Bank of Am., N.A.* v. *Boykins*, No. 13-14908 (11th Cir.); *Bank of Am., N.A.* v. *Braswell*, No. 13-15777 (11th Cir.); *Bank of Am., N.A.* v. *Brown*, No. 13-14298 (11th Cir.); *Bank of Am., N.A.* v. *Buenasola*, No. 13-15037 (11th Cir.); *Bank of Am., N.A.* v. *Garro*, No. 14-11676 (11th Cir.); *Bank of Am., N.A.* v. *Hamilton-Presha*, No. 14-10137 (11th Cir.); *Bank of Am., N.A.* v. *Johnson*, No. 14-11387 (11th Cir.); *Bank of N.Y. Mellon* v. *Lang*, No. 14-11373 (11th Cir.); *Bank of Am, N.A.* v. *Lee*, No. 14-11353 (11th Cir.); *Bank of Am., N.A.* v. *Lopez*, No. 14-10518 (11th Cir.); *Bank of Am., N.A.* v. *Madden*, No. 13-14438 (11th Cir.); *Bank of Am., N.A.* v. *Nemcik*, No. 14-11290 (11th Cir.); *Bank of Am., N.A.* v. *Peele*, No. 13-15839 (11th Cir.); *Bank of Am., N.A.* v. *Waits*, No. 14-11408 (11th Cir.); *Bank of Am., N.A.* v. *Lakhani*, No. 14-12749 (11th Cir.); *Bank of Am., N.A.* v. *Phillips*, No. 14-12585 (11th Cir.); *Bank of Am., N.A.* v. *Vander Iest*, No. 14-12486 (11th Cir.); *Bank of Am., N.A.* v. *Vander Iest*, No. 14-12406 (11th Cir.); *Bank of Am., N.A.* v. *Evans*, No. 14-12887 (11th Cir.); *Bank of Am., N.A.* v. *Farmer*, No. 14-12444 (11th Cir.); *Bank of Am., N.A.* v. *Hall*, No. 14-11292 (11th Cir.); *Bank of Am., N.A.* v. *Allen*, No. 14-13002 (11th Cir.); *Bank of Am., N.A.* v. *Beursken*, No. 14-12546 (11th

many of these proceedings, the debtor is attempting to reopen a chapter 7 case that was closed months or even years ago in order to strip off a junior lien on the debtor's property. *See, e.g.*, *In re Davis*, No. 12-21148 (Bankr. N.D. Ga.) (bankruptcy case was closed in July 2012, but debtor filed strip-off motion in October 2013).

Cir.); *Bank of Am., N.A.* v. *Sardina*, No. 14-12563 (11th Cir.); *Bank of Am., N.A.* v. *Glaspie*, No. 14-743 (N.D. Ga.); *Bank of Am., N.A.* v. *Pampalon*, No. 14-2235 (N.D. Ga.); *Bank of Am., N.A.* v. *Bogdan*, No. 14-1598 (N.D. Ga.); *Bank of Am., N.A.* v. *Rayoni*, No. 14-2172 (N.D. Ga.); *Bank of Am., N.A.* v. *Miller*, No. 14-1377 (N.D. Ga.); *Bank of Am., N.A.* v. *Cumpson*, No. 14-2022 (N.D. Ga.); *Bank of Am., N.A.* v. *Marshall*, No. 14-2412 (N.D. Ga.); *Bank of Am., N.A.* v. *Brantley*, No. 14-774 (M.D. Fla.); *Bank of Am., N.A.* v. *Corrad*, No. 14-343 (M.D. Fla.); *Bank of Am., N.A.* v. *Hawkins*, No. 14-1088 (M.D. Fla.); *Bank of Am., N.A.* v. *Hackbart*, No. 14-1398 (M.D. Fla.); *In re Auriemmo*, No. 13-69444 (Bankr. N.D. Ga.); *In re Copeland*, No. 13-74750 (Bankr. N.D. Ga.); *In re Langford*, No. 13-74530 (Bankr. N.D. Ga.); *In re Lomax*, No. 13-62584 (Bankr. N.D. Ga.); *In re Maclin*, No. 13-76374 (Bankr. N.D. Ga.); *In re McDonald*, No. 13-11522 (Bankr. N.D. Ga.); *In re Rubio*, No. 13-43150 (Bankr. N.D. Ga.); *In re Smart*, No. 13-13053 (Bankr. N.D. Ga.); *In re Yarbrough*, No. 13-12547 (Bankr. N.D. Ga.); *In re Jackson*, No. 14-40990 (Bankr. N.D. Ga.); *In re Orea*, No. 13-20338 (Bankr. N.D. Ga.); *In re Charles*, No. 14-63276 (Bankr. N.D. Ga.); *In re Clay*, No. 14-60701 (Bankr. N.D. Ga.); *Thomas* v. *Bank of Am., N.A.*, No. 14-3032 (Bankr. M.D. Ga.); *In re Colon*, No. 13-13430 (Bankr. M.D. Fla.); *In re Corrad*, No. 14-5054 (Bankr. M.D. Fla.); *In re Gnerre*, No. 13-8158 (Bankr. M.D. Fla.); *In re Scharboneau*, No. 13-6751 (Bankr. M.D. Fla.); *In re Tower*, No. 13-10941 (Bankr. M.D. Fla.); *Million* v. *Bank of Am., N.A.*, No. 13-435 (Bankr. M.D. Fla.); *Violenusellis* v. *Bank of Am., N.A.*, No. 14-151 (Bankr. M.D. Fla.); *In re Fenton*, No. 14-868 (Bankr. M.D. Fla.); *In re Herrick*, No. 14-1087 (Bankr. M.D. Fla.); *In re Rodriguez*, No. 14-3540 (Bankr. M.D. Fla.); *In re Melendez*, No. 14-6291 (Bankr. M.D. Fla.); *In re Parada*, No. 14-6063 (Bankr. M.D. Fla.); *In re Gilleland*, No. 13-11801 (Bankr. M.D. Fla.); *In re Amador*, No. 13-15740 (Bankr. S.D. Fla.); *In re Corriveau*, No. 13-40717 (Bankr. N.D. Fla.); *In re Mayo*, No. 14-30209 (Bankr. N.D. Fla.); *In re Tabares*, No. 14-22694 (Bankr. S.D. Fla.).

Faced with this onslaught of motions, bankruptcy courts within the Eleventh Circuit have repeatedly expressed the need for guidance from a higher court. As one bankruptcy judge recently put it, "I really think the Eleventh Circuit did not correctly decide *McNeal*, but ... I'm bound by that .... [T]here is a conflict in the circuits .... So something needs to happen somewhere." Tr. 6, *In re Langford*, No. 13-74530 (Bankr. N.D. Ga. Mar. 6, 2014); *see also, e.g.*, *In re Valone*, 500 B.R. 645, 650 n.23 (Bankr. M.D. Fla. 2013) (noting that "[t]he ability of chapter 7 debtors to strip off junior mortgages is questionable" but that *McNeal* so held); Tr. 6-7, *In re Jackson*, No. 14-40990 (Bankr. N.D. Ga. July 30, 2014) (granting motion to strip off junior lien in light of *McNeal* but noting that the court believes *McNeal* was wrongly decided and that the Eleventh Circuit or Supreme Court "ought to address" the issue); Tr. 2, *In re Tower*, No. 13-10941 (Bankr. M.D. Fla. Feb. 13, 2014) (noting that the court has "been granting these strip-offs because [*McNeal*] is the circuit precedent," although the court "frankly agree[d] with [Bank of America]").

Were the practice of voiding wholly underwater junior liens to spread beyond the Eleventh Circuit, it could have unexpected and undesirable consequences. As Judge Posner has noted, "bankruptcy provisions 'friendly to debtors' are so only in the short run; in the long run, the fewer rights that creditors have in the event of default, the higher interest rates will be to compensate creditors for the increased risk of loss." *In re River E. Plaza, LLC*, 669 F.3d 826, 833 (7th Cir. 2012). Secured loans, including home mortgages, provide borrowers with lower interest rates precisely because the creditor can look to its lien for repayment if the debtor defaults. *See* Mann, *Explaining the Pattern of Secured Credit*, 110 Harv. L. Rev. 625, 683 (1997).

And a lien has value to a creditor even if it is currently underwater because the property securing the lien may appreciate in the future, causing the lien to regain value as well. *Dewsnup* explained that this appreciation in value "rightly accrues to the benefit of the creditor." 502 U.S. at 417. But the Eleventh Circuit's rule changes that equation, depriving junior lenders of their bargained-for rights and potentially leading to costlier mortgages.

Given the practical and economic importance of the question presented, the sheer volume of cases presenting this issue, *see supra* n.5, and the need for uniformity among the circuits in this central aspect of chapter 7 practice, the Eleventh Circuit's wrong-headed approach warrants immediate review. Like *Caulkett*, this case presents an ideal opportunity: There are no facts in dispute; the case is a particularly clean vehicle for reaching and deciding the question presented; and there is no need for further percolation in the lower courts because the question has been fully aired over the twenty years since *Dewsnup* and thoroughly discussed in decisions by four different courts of appeals. The Eleventh Circuit has also made clear that it will not reconsider its position. In short, there is no reason for delay. This Court should grant review of this issue now and reverse the Eleventh Circuit.

CONCLUSION

The petition for a writ of certiorari in *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, should be granted and this petition held pending that case's disposition. In the alternative, the petition in this case should be granted.

Respectfully submitted.

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AUGUST 2014

APPENDIX

APPENDIX A

[DO NOT PUBLISH]

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 13-15855
Non-Argument Calendar

D.C. Docket Nos. 8:13-cv-02558-SDM,
8:13-bk-05393-KRM

IN RE: EDELMIRO TOLEDO-CARDONA,
Debtor.

BANK OF AMERICA, NA,
Plaintiff-Appellant,

versus

EDELMIRO TOLEDO-CARDONA,
Defendant-Appellee.

Appeal from the United States District Court
for the Middle District of Florida

(May 15, 2014)

Before TJOFLAT, MARTIN, and JORDAN, Circuit Judges.

PER CURIAM:

Bank of America appeals from the district court's order affirming an order from the bankruptcy court voiding Bank of America's lien on Edelmiro Toledo-

Cardona's property in a Chapter 7 bankruptcy proceeding he initiated. Toledo-Cardona's property was subject to two mortgage liens at the time he filed for bankruptcy. The debt owed on the first mortgage exceeded the fair market value of the property. Bank of America held the second mortgage, which had a value of over $100,000. Because the debt secured by the first lien exceeded the value of the property, Bank of America's junior lien was considered to be wholly "underwater." This being the case, Toledo-Cardona moved the bankruptcy court to "strip off" or "void"—that is, extinguish in its entirety—Bank of America's lien.

Bank of America's response to Toledo-Cardona's motion acknowledged that under binding Eleventh Circuit precedent holding that a wholly underwater junior lien is voidable, Toledo-Cardona's motion should be granted. *See Folendore v. U.S. Small Bus. Admin.*, 862 F.2d 1537, 1538-39 (11th Cir. 1989); *see also McNeal v. GMAC Mortg., LLC*, 735 F.3d 1263, 1265-66 (11th Cir. 2012) (per curiam). For that reason, the bankruptcy court granted Toledo-Cardona's motion. Bank of America appealed to the district court, but moved for summary affirmance in light of this Court's binding precedent. The district court granted the motion, and Bank of America now seeks the appellate review that its motion for summary affirmance was intended to expedite.

Bank of America maintains that *Folendore* and *McNeal* should be overturned in light of *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992), which held that a chapter 7 debtor could not "strip down" a creditor's lien on real property where the value of the property is less than what is due to be paid to the creditor. *Id.* at 417, 112 S. Ct. at 778. But in *McNeal*, we reaffirmed *Folendore* despite the holding in *Dewsnup*.

McNeal, 735 F.3d at 1265-66. As Bank of America concedes, we are bound as a panel to follow our Court's decision in *McNeal*. We therefore **AFFIRM**.

APPENDIX B

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

Case No.: 8:13-cv-2558-T-23

BANK OF AMERICA, N.A.,

Appellant,

v.

EDELMIRO TOLEDO-CARDONA,

Appellee.

December 13, 2013

ORDER

Bank of America's amended, unopposed motion (Docs. 11 and 12) for summary affirmance is **GRANTED**, and the bankruptcy judge's September 10, 2013, order (Doc. 1-3) granting Edelmiro Toledo-Cardona's verified motion (Doc. 1-7) to determine Bank of America's secured status and to strip Bank of America's lien on discharge is **AFFIRMED**.*

The clerk will close the case and enter judgment accordingly.

ORDERED in Tampa, Florida, on December 13, 2013.

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* Bank of America's original motion (Doc. 10) is **DENIED AS MOOT**.

/s/ Steven D. Merryday
STEVEN D. MERRYDAY
UNITED STATES DISTRICT JUDGE

APPENDIX C

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

Case No.: 8:13-bk-05393-KRM
Chapter 7

IN RE: EDELMIRO TOLEDO-CARDONA,
Debtor.

September 10, 2013

ORDER GRANTING VERIFIED MOTION TO DETERMINE SECURED STATUS OF BANK OF AMERICA, N.A. AND TO STRIP LIEN EFFECTIVE ON DISCHARGE

THIS CASE came on for hearing on September 3, 2013, upon Debtor's Motion to Determine Secured Status of Bank of America, N.A. and to Strip Lien Effective Upon Discharge (Docket #8). If Bank of America, N.A. has not timely filed a proof of claim in this case, the Motion is not deemed to be an informal proof of claim except for the purpose of initiating the Debtor's ability to request relief pursuant to 11 U.S.C. §506(a).

The real property (the "Real Property") that is the subject of the Motion is located at 6906 E Creek Dr, Tampa, Hillsborough County, Florida, and more particularly described as follows:

The Southerly 80 fee of Lot 4, Block 5, BYARS HEIGHTS RESUBDIVISION of Block 5, as

recorded in Plat Book 32, Page 84, of the Public Records of Hillsborough County, Florida.

Parcel ID: U-27-28-17-0AW-000005-00004.0

For reasons stated orally and recorded in open Court that shall constitute the decision of this Court, it is

ORDERED:

1. The Motion is GRANTED.

2. If Bank of America, N.A. timely filed a proof of claim, the claim shall be treated as an unsecured claim in this Chapter 7 case.

3. The mortgage on the Real Property held by Bank of America, N.A on November 29 2007 in Official Record Book 18281, Page 1801 1808, Instrument #2007500493 of the official records of Hillsborough County, Florida, shall be deemed void, and shall be extinguished automatically, without further court order, upon the recordation in the public records of a certified copy of this Order together with (a) a certified copy of the Debtors' Chapter 7 discharge order in this case or (b) such other papers the Court may specify by separate order. However, the Court reserves jurisdiction to consider, if appropriate, the avoidance of Bank of America, N.A.'s mortgage lien prior to entry of the Debtor's discharge.

4. This Order does not prevent Bank of America, N.A. from asserting, at any time prior to entry of the Debtor's discharge, any rights it may have as a defendant in any foreclosure proceeding brought by a senior mortgagee, including the right to claim excess proceeds from any foreclosure sale.

DONE and ORDERED in Tampa, Florida on September 10, 2013.

/s/ K. Rodney May
K. Rodney May
United States Bankruptcy Judge

Attorney Kelley M. Petry is directed to serve a copy of this order on interested parties and file a proof of service within 3 days of entry of the order.

Copies furnished to:
Kelley M. Petry, Esq., attorney for debtor, P.O. Box 7866, Tampa, FL 33673
Shari Streit Jansen, trustee, P.O. Box 50667, Sarasota, FL 34232
Edelmiro Toledo Cardona, debtor, 6906 E Creek Dr, Tampa, FL 33615
Bank of America, N.A., Bankruptcy Department, P.O. Box 26012, NC4-105-02-99, Greensboro, NC 27420
Bank of America, N.A., c/o CT Corporation System, Registered Agent, 1200 S. Pine Island Dr., Plantation, FL 33324
Bank of America, N.A., c/o Bruce R. Thompson, Chief Financial Officer, 150 N. College St., NC1-028-17-06, Charlotte, NC 28255
Emily Y. Rottman, Esq., 50 N. Laura St, Ste 3300, Jacksonville, FL 32202

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 11-11352
Non-Argument Calendar

D.C. Docket Nos. 1:10-cv-01612-TCB;
09-BKC-78173-PWB

IN RE: LORRAINE MCNEAL,

Debtor.

LORRAINE MCNEAL,

Plaintiff-Appellant,

v.

GMAC MORTGAGE, LLC, HOMECOMINGS FINANCIAL, LLC, a GMAC company,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Georgia

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Filed: May 11, 2012
[735 F.3d 1263]

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* * *

[1264] Before TJOFLAT, EDMONDSON, and CARNES, Circuit Judges.

PER CURIAM:

Lorraine McNeal appeals the district court's affirmance of the bankruptcy court's denial of McNeal's "Motion to Determine the Secured Status of Claim." In her motion, McNeal sought to "strip off"[1] a second priority lien on her home, pursuant to 11 U.S.C. § 506(a) and (d). Reversible error has been shown; we reverse and remand for additional proceedings.

McNeal filed a voluntary petition for bankruptcy under Chapter 7 of the Bankruptcy Code. In her petition, McNeal reported that her home was subject to two mortgage liens: a first priority lien in the amount of $176,413 held by HSBC and a second priority lien in the amount of $44,444 held by Homecomings Financial, LLC, a subsidiary of GMAC Mortgage, LLC (colletively, "GMAC"). McNeal also reported that her home's fair market value was $141,416. The parties do not dispute these factual allegations.

McNeal then sought to "strip off" GMAC's second priority lien, pursuant to sections 506(a) and 506(d). McNeal contended that, because the senior lien exceeded the home's fair market value, GMAC's junior lien was wholly unsecured and, thus, void under section 506(d). The bankruptcy court denied the motion, concluding that section 506(d) did not permit a Chapter 7 debtor to "strip off" a wholly unsecured lien. The district court affirmed.

When the district court affirms the bankruptcy court's order, we review only the bankruptcy court's decision on appeal. *Educ. Credit Mgmt. Corp. v. Mosley*, 494 F.3d 1320, 1324 (11th Cir. 2007). And we review the bankruptcy court's legal conclusions *de novo*.

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[1] In bankruptcy terms, a "strip down" of an undersecured lien reduces the lien to the value of the collateral to which it attaches and a "strip off" removes a wholly unsecured lien in its entirety.

Hemar Ins. [1265] *Corp. of Am. v. Cox*, 338 F.3d 1238, 1241 (11th Cir. 2003).

That GMAC's junior lien is both "allowed" under 11 U.S.C. § 502 and wholly unsecured pursuant to section 506(a) is undisputed.[2] To determine whether such an allowed—but wholly unsecured—claim is voidable, we must then look to section 506(d), which provides that "[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void." *See* 11 U.S.C. § 506(d).

Several courts have determined that the United States Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992)—which concluded that a Chapter 7 debtor could not "strip down" a partially secured lien under section 506(d)—also precludes a Chapter 7 debtor from "stripping off" a wholly unsecured junior lien such as the lien at issue in this appeal. *See, e.g.*, *Ryan v. Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001); *Talbert v. City Mortg. Serv.*, 344 F.3d 555 (6th Cir. 2003); *Laskin v. First Nat'l Bank of Keystone*, 222 B.R. 872 (B.A.P. 9th Cir. 1998). But the present controlling precedent in the Eleventh Circuit remains our decision in *Folendore v. United States Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989). In *Folendore*, we concluded that an allowed claim that was wholly unsecured—just as GMAC's claim is here—was voidable

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[2] 11 U.S.C. § 506(a) provides in pertinent part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.

under the plain language of section 506(d).[3] 862 F.2d at 1538-39.

A few bankruptcy court decisions within our circuit—including the decision underlying this appeal—have treated *Folendore* as abrogated by *Dewsnup*. *See, e.g.*, *In re McNeal*, No. A09-78173, 2010 Bankr. LEXIS 1350, at *9-12 (Bankr. N.D. Ga. Apr. 9, 2010); *In re Swafford*, 160 B.R. 246, 249 (Bankr. N.D. Ga. 1993); *In re Windham*, 136 B.R. 878, 882 n.6 (Bankr. M.D. Fla. 1992). But *Folendore*—not *Dewsnup*—controls in this case.

"Under our prior panel precedent rule, a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is 'clearly on point.'" *Atl. Sounding Co., Inc. v. Townsend*, 496 F.3d 1282, 1284 (11th Cir. 2007). Because *Dewsnup* disallowed only a "strip down" of a partially secured mortgage lien and did not address a "strip off" of a wholly unsecured lien, it is not "clearly on point" with the facts in *Folendore* or with the facts at issue in this appeal.

Although the Supreme Court's reasoning in *Dewsnup* seems to reject the plain language analysis that we used in *Folendore*, "'[t]here is, of course, an important difference between the holding in a case and the reasoning that supports that holding.'" *Atl. Sounding Co., Inc.*, 496 F.3d at 1284 (citing *Crawford-El v. Britton*, 118 S. Ct. 1584, 1590 (1998)). "[T]hat the reasoning of an intervening high court decision is at odds with that of our prior decision is no basis for a panel to depart from our prior decision." *Id.* "As we have stat-

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[3] Although *Folendore* addressed the 1978 version of the Bankruptcy Code, the 1984 amendments to the Code did not alter the pertinent language in section 506(a) or (d).

ed, '[o]bedience to a Supreme Court decision is one thing, extrapolating from its implications a holding on an issue that was not before that Court in order to upend settled circuit [1266] law is another thing." *Id.* In fact, the Supreme Court—noting the ambiguities in the bankruptcy code and the "the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations"—limited its *Dewsnup* decision expressly to the precise issue raised by the facts of the case. 112 S. Ct. at 778.

Because—under *Folendore*—GMAC's lien is voidable under section 506(d), we reverse and remand for additional proceedings consistent with this decision.

REVERSED AND REMANDED.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 11-11352-CC

IN RE: LORRAINE MCNEAL,

Debtor.

LORRAINE MCNEAL,

Plaintiff-Appellant,

versus

GMAC MORTGAGE, LLC, HOMECOMINGS FINANCIAL, LLC, a GMAC Company,

Defendants-Appellees.

On Appeal from the United States District Court for the Northern District of Georgia

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Filed: May 20, 2014

Before: TJOFLAT, EDMONDSON, and CARNES, Circuit Judges.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure), the Petition(s) for Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:

/s/ J.L. Edmondson
UNITED STATES CIRCUIT JUDGE

Supreme Court, U.S.
FILED
OCT 6 - 2014
OFFICE OF THE CLERK

No. 14-163

In The Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court held that a claim in a Chapter 7 bankruptcy proceeding remains an "allowed secured claim" under 11 U.S.C. § 506(d) – and a lien securing the claim therefore remains valid – even if the claim is only partially secured under 11 U.S.C. § 506(a). The question presented is whether a claim remains an "allowed secured claim" under Section 506(d) if it becomes entirely *un*secured under Section 506(a).

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In The Supreme Court of the United States

No. 14-163

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

BRIEF IN OPPOSITION

STATEMENT

Petitioner conflates first mortgages with second mortgages and partially secured claims with entirely unsecured claims. Rather than focusing on the text of the Bankruptcy Code, petitioner urges this Court to expand *Dewsnup*'s holding to cases far beyond its limited rationale and limited context. *Dewsnup* held that *partially* secured mortgages remain valid through bankruptcy but had no occasion to address *entirely unsecured* junior claims, such as the one here. Indeed, this Court carefully limited *Dewsnup*'s holding to the particular facts of that case and rested

on historical and policy considerations that applied there but not here.

Two of the three supposedly contrary decisions cited by petitioner are old, none is entrenched, and none grapples with the historical and policy concerns peculiar to second mortgages that would be entirely worthless in foreclosure. This Court rightly denied certiorari on a near-verbatim petition with the same petitioner, the same counsel, the same question presented, the same circuit, and the same vehicle problem just seven months ago. Further review is unwarranted.

1. Since at least the nineteenth century, bankruptcy law has served two primary purposes. The first is to "convert the estate of the bankrupt into cash and distribute it among creditors." *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913). The second is to "give the bankrupt a fresh start." *Id.* To distribute the debtor's estate equitably, a Chapter 7 liquidation first satisfies secured claims by selling the underlying property, and then distributes the estate's remaining assets pro rata among the unsecured creditors. *See* 11 U.S.C. §§ 506, 726(b).

An "allowed claim" is a claim eligible to participate in the distribution of estate assets. *See, e.g.*, 11 U.S.C. §§ 502, 724(b), 726(a)(2). Within the set of "allowed claim[s]," 11 U.S.C. § 506(a) specifies which claims qualify as "secured claim[s]" or "unsecured claim[s]":

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property and is an unsecured claim to the extent that the value of such creditor's interest is less than the amount of such allowed claim.

11 U.S.C. § 506(a)(1). In other words, in bankruptcy, an allowed claim can remain entirely secured; become entirely unsecured; or be bifurcated into secured and unsecured claims.

For example, a $150,000 first mortgage and a $25,000 second mortgage on a home are both "secured" loans outside of bankruptcy because the home is pledged as collateral backing the loan. But if, for example, the property's value drops from $200,000 to $100,000, the first mortgage becomes undersecured, or "partially underwater." In that situation, because the first mortgage is senior to the second, the value of the home is applied to the first mortgage before the second. In bankruptcy, Section 506(a) bifurcates the first mortgagee's claim into a $100,000 secured claim and a $50,000 unsecured claim. Because the second mortgage is "entirely underwater" (that is, there is no remaining value in the property to secure the debt), Section 506(a) leaves the second mortgagee with only a $25,000 *un*secured claim. 11 U.S.C. § 506(a)(1). If the first mortgagee forecloses on the home and sells it for $100,000, the second mortgagee receives no proceeds from the foreclosure.

After a bankruptcy court separates allowed secured and allowed unsecured claims under Section 506(a), it must next determine which liens are void under Section 506(d). That subsection provides, with exceptions not relevant here, that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). If a lien is void, the creditor can still receive distributions from the estate along with the other unsecured creditors.

2. In *Dewsnup*, this Court considered the application of Section 506 to a situation in which the value of the debtor's house had fallen below the value of her first and only mortgage – *i.e.*, the mortgage was partially underwater. 502 U.S. at 411-12. This Court acknowledged that the more natural reading of the statute's text would void the portion of the lien that was underwater at the time of the bankruptcy proceeding. *Id.* at 417.

This Court was concerned, however, that a later increase in the property's value would give the debtor a windfall. 502 U.S. at 417. To prevent that unfairness, and to honor the original bargain between the mortgagor and mortgagee as well as the history that liens ride through bankruptcy, *Dewsnup* read the phrase "allowed secured claim" to include undersecured claims. *Id.* at 417-20.

Emphasizing "the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations," and acknowledging that this

reading of the text was "not without its difficulty," this Court "focus[ed] upon the case before [it] and allow[ed] other facts to await their legal resolution on another day." 502 U.S. at 416-17.

3. Respondent Edelmiro Toledo-Cardona purchased his home in Tampa, Florida in 2001 for $80,000, taking out an $82,872 mortgage to cover the purchase price and closing costs.[1] Thus, his initial loan-to-value ratio was 103.6%. In 2012, Mr. Toledo-Cardona refinanced his first mortgage with a new $135,900 loan originated by Quicken Loans. Mortgage, MIN 100039033106848207 (Dec. 31, 2012), *available at* http://tinyurl.com/QuickenRefinance. At the time of this refinancing, the property was also encumbered by a $32,000 second mortgage that had been originated by Countrywide Bank in 2007. Pl.'s Verified Mot. to Determine Secured Status 2, *In re Toledo-Cardona*, No. 8:13-bk-05393-KRM (Bankr. M.D. Fla. June 7, 2013) [hereafter Pl.'s Mot.]. Petitioner had purchased Countrywide in early 2008, acquiring rights to Mr. Toledo-Cardona's second mortgage. *Id.* By agreement, Countrywide subordinated its

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[1] Mortgage, MIN 1000169-0003690203-0 (June 8, 2011), *available at* http://tinyurl.com/ToledoCardonaMortgage. It is necessary to cite the public real estate record for this mortgage, as well as for the refinancing and subordination agreement mentioned later in the textual paragraph, because the factual record below was not developed to include information regarding the original purchase of the property, the refinancing, the interest rates and similar terms of either mortgage, or the subordination agreement.

mortgage to the new Quicken loan. Subordination Agreement, MIN 1001337-0002602974-7 (Dec. 14, 2012), *available at* http://tinyurl.com/BankofAmerica Subordination.

Mr. Toledo-Cardona filed a Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the Middle District of Florida in April 2013. Pl.'s Mot. 1. At the time, his home was valued at $77,689, while the outstanding balances on his mortgages were $135,703 and $32,000, respectively. *Id.* at 2. It thus appears that petitioner's second mortgage may have provided for payments only of interest, not of principal. The first mortgage had a loan-to-value ratio of 174.7% and the two mortgages had a combined loan-to-value ratio of 215.9%.

Mr. Toledo-Cardona moved to void petitioner's junior lien under 11 U.S.C. § 506(a) and (d) on the ground that it was entirely underwater. Pet. App. 7a-9a. Petitioner conceded that the lien was void under circuit precedent. *Id.* at 2a. The bankruptcy court then voided the lien in a two-page order. *Id.* at 7a-9a. On appeal to the district court, petitioner reserved its right to challenge circuit precedent but moved for summary affirmance of the judgment against it. *Id.* at 2a. The district court summarily affirmed in a one-page order. *Id.* at 5a-6a. The Eleventh Circuit affirmed in an unpublished, three-paragraph per curiam opinion. *Id.* at 1a-3a.

REASONS FOR DENYING THE PETITION

Nothing about the short per curiam decision below warrants this Court's review. An entirely underwater second mortgage "is an unsecured claim" under 11 U.S.C. § 506(a), as petitioner concedes. Pet. 5-6. Thus, it "is not an allowed secured claim," and its associated lien "is void" under Section 506(d). This Court's carefully limited holding in *Dewsnup* is not to the contrary: it depended on the historical treatment of first-mortgage liens and two policy considerations concerning such liens, none of which applies to entirely unsecured second mortgages.

Over the past four decades, only a handful of circuits have weighed in on the question presented. None of the circuits relied on by petitioner has entrenched its position, and none has considered whether or how the relevant policies and history apply to entirely underwater second mortgages. Furthermore, petitioner has rushed this case along, resulting in skeletal factual development and depriving the court of appeals of the opportunity to address in detail (and refute) the arguments petitioner now advances.

Earlier this year, this Court denied certiorari on the same question presented, in a case plagued by the same vehicle problem. *Bank of America* v. *Sinkfield*, 134 S. Ct. 1760 (2014) (No. 13-700) (denying certiorari). It should do the same here.

I. There Is No Entrenched Difference Among the Circuits That Warrants This Court's Review

Further percolation is needed because any claimed divergence among the circuits is shallow and immature. Apart from the court below, only three other courts of appeals have taken positions on the question presented. *Palomar* v. *First Am. Bank*, 722 F.3d 992, 993-96 (7th Cir. 2013); *Talbert* v. *City Mortg. Servs.* (*In re Talbert*), 344 F.3d 555, 557-62 (6th Cir. 2003); *Ryan* v. *Homecomings Fin. Network*, 253 F.3d 778, 781-83 (4th Cir. 2001). No additional courts of appeals have weighed in since this Court denied certiorari in *Sinkfield* seven months ago. Eight of the twelve circuits, in which a majority of Chapter 7 bankruptcies are filed, have yet to address the issue.[2]

This paucity of circuit precedent in the thirty-six years since the passage of the 1978 Bankruptcy Code suggests that the issue is not nearly as common or important as petitioner contends. As the wild lending practices that characterized the pre-2008 housing market recede into the past and precarious second mortgages unsupported by equity become much less

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[2] *See* UNITED STATES COURTS, REPORT F-5A: U.S. BANKRUPTCY COURTS: BUSINESS AND NONBUSINESS CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE, DURING THE 12-MONTH PERIOD ENDING JUNE 30, 2014 (2014), *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2014/0614_f5a.pdf.

common, the question presented is likely to arise even more rarely.

In the circuits that bar courts from voiding entirely underwater liens, rehearing en banc has never been sought by any of the parties or granted sua sponte by the court. So none of the circuit precedents on petitioner's side of the issue has been entrenched en banc. Additionally, two of the three circuits on which petitioner relies – the Sixth Circuit in *Talbert* and the Fourth Circuit in *Ryan* – considered the issue more than a decade ago, well before the financial-crisis spike in bankruptcy filings.

Moreover, this Court does not have the benefit of any criticism or reactions by any courts of appeals to one another's opinions. Both the Fourth and Sixth Circuit's opinions were decided long before the Eleventh Circuit took its position, and they failed to discuss the many differences between partially underwater first mortgages and entirely underwater second mortgages, as discussed *infra* pp.13-19. And while the debtor's brief in *Palomar* mentioned the Eleventh Circuit's decision in *McNeal* v. *GMAC Mortgage, LLC* (*In re McNeal*), 735 F.3d 1263 (11th Cir. 2012), *reh'g en banc denied* (11th Cir. May 20, 2014), the Seventh Circuit in *Palomar* never mentioned the Eleventh Circuit's decision, let alone confronted its underlying rationales.

Finally, in two of the three decisions that barred courts from voiding second-mortgage liens, those mortgages were only slightly underwater. *Talbert*,

344 F.3d at 556-57 (noting that the second mortgage was secured by a "'valueless' lien" because the first mortgage was $2,633 underwater); *Ryan*, 253 F.3d at 779 (first mortgage was $2,826 underwater). Both courts worried that the debtors could reap a "windfall," as in *Dewsnup*, if the property values increased even slightly after the liens were voided. *Talbert*, 344 F.3d at 559, 561 (quoting *Dewsnup*, 502 U.S. at 417); *Ryan*, 253 F.3d at 782-83 (same). Those borderline cases differ substantially from this case, where petitioner's second lien will remain worthless except in the unlikely event that Mr. Toledo-Cardona's home nearly doubles in value.

Thus, neither the Fourth nor the Sixth Circuit has had to grapple with truly valueless second liens that serve only to obstruct possible consensual resolutions. That dimension was also absent in *Dewsnup*, which pitted a single debtor against a single creditor. If confronted with a case like this one, these circuits might well agree with the court below and distinguish the case from *Dewsnup*. *Infra* pp.13-16. In short, further percolation is warranted.

II. Section 506(d) of the Bankruptcy Code Expressly Voids Second Liens That Are Entirely Underwater and Thus Entirely Unsecured Under Section 506(a)

1. The text of the statute is clear. As petitioner concedes, entirely underwater mortgages are entirely unsecured claims in bankruptcy, under 11 U.S.C.

§ 506(a)(1). Pet. 5-6. That subsection provides: "An allowed claim of a creditor secured by a lien on property is an unsecured claim to the extent that the value of such creditor's interest is less than the amount of such allowed claim." Thus, an entirely underwater second mortgage is an entirely "unsecured claim."

Section 506(d) addresses the corresponding question of which liens backing those claims are void. It provides, with exceptions not relevant here, that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."

According to the plain language of these provisions, if a claim is entirely underwater and thus an entirely "unsecured claim" under Section 506(a), it "is not an allowed secured claim" and "such lien is void" under Section 506(d).

2. That statutory text is unaltered by *Dewsnup*'s carefully limited holding. *Dewsnup* addressed an undersecured first mortgage, which resulted in a claim that remained partially secured under Section 506(a). One could have conceptualized that claim either as one secured claim plus one unsecured claim (with the latter resulting in a void lien under Section 506(d)) or as a single hybrid secured/unsecured claim (which remained "secured," and thus not void, under Section 506(d)). The creditor's reading of the statute, which treated a partially underwater claim as one single "allowed secured claim" notwithstanding

Section 506(a), was "not without its difficulty." *Dewsnup*, 502 U.S. at 417. The Court thus acknowledged that it "might be inclined to agree," based on the text of the statute, that the debtor's reading is correct and that the two subsections operate together to void the underwater portions of partially underwater liens. *Id.*

But two policy considerations plus the historical treatment of liens persuaded the *Dewsnup* Court to deviate from the more natural reading of the text. 502 U.S. at 417-20. First, *Dewsnup* was intent on preventing debtors from reaping windfalls. Voiding the underwater portion of a lien could result in such a windfall if the property later increased in value, *Dewsnup* feared. *Id.* at 417. Second, *Dewsnup* noted, the mortgagee had originally bargained for priority over the debtor and other creditors "who had nothing to do with the mortgagor-mortgagee bargain." *Id.* Voiding the underwater portion of the lien would renegotiate that bargain, subverting the priority for which the mortgagee had bargained. Finally, *Dewsnup* also relied on the historical practice of liens riding through bankruptcy. The *Dewsnup* Court thus declined to read the statute as "effect[ing] a major change in pre-Code practice." *Id.* at 419.

This Court was exceptionally careful to confine *Dewsnup*'s scope to the particular factual setting before it. It emphasized "the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations." *Dewsnup*, 502 U.S. at 416. It took pains to resolve only "the case before [it] and

allow other facts to await their resolution on another day." *Id.* at 416-17. This Court thus warned against what petitioner seeks to do here: expand *Dewsnup*'s reasoning to this very different factual and legal context. *Cf. Crawford-El* v. *Britton*, 523 U.S. 574, 585 (1998) ("There is, of course, an important difference between the holding in a case and the reasoning that supports that holding.").

3. In the situation considered in *Dewsnup*, the first mortgage was merely *under*secured, not entirely *un*secured, because it was only partially underwater. (In practice, real property never becomes entirely valueless. So, absent a supervening lien, first mortgages do not sink entirely underwater; only junior mortgages do.) Thus, in *Dewsnup*, the mortgage included secured components and still qualified as "an allowed secured claim." As explained below, *Dewsnup*'s policy and historical concerns do not apply equally to second mortgages that are entirely underwater, with no remaining secured components. There is no compelling reason to stretch the phrase "allowed secured claim" beyond *partially secured* claims to embrace *entirely unsecured* claims as well.

a.i. *Voiding Worthless Junior Liens Benefits Senior Creditors, Not Just Debtors.* *Dewsnup*'s primary rationale, preventing windfalls to debtors if property later appreciates, is much less applicable to entirely underwater junior liens. *Dewsnup* feared that if a court could void the underwater portion of a first lien and the property later rose in value, the debtor – rather than the creditor – would reap the

future gain. 502 U.S. at 417. But if a court voids an entirely underwater junior lien, any future appreciation goes first and foremost to the partially underwater senior creditor, not the debtor. Here, Mr. Toledo-Cardona's home would have to nearly double in value before the senior creditor's claim would be satisfied. Moreover, foreclosed homes typically sell at depressed prices, and proceeds must also pay the costs of foreclosure. Thus, in practice, any increase in property value would have to be even greater before there would be any value left over for a debtor, or a junior creditor like petitioner. There is usually nothing left over to give a debtor a "windfall."

ii. Not only does voiding junior liens give debtors few if any "windfalls," but it also helps senior creditors maximize the value of their own secured claims and unclog the housing market. Voiding junior liens is sometimes the only way to stop junior lienholders from obstructing mutually beneficial bargains between senior creditors and debtors.

To avoid bankruptcy or foreclosure, debtors can negotiate consensual resolutions with their mortgagees. Creditors typically prefer to avoid foreclosures, because the process can take many months, result in substantial legal fees, and reap prices well below market value. Instead, senior creditors may try to strike deals with debtors, such as agreeing to short sales (for less than the first mortgage balance), refinancing their debts, or writing down mortgage balances so debtors will keep making payments on underwater loans. These consensual resolutions are

generally faster, net higher payouts to creditors, and sometimes let debtors keep their homes instead of abandoning them.

But junior lienholders often use entirely underwater second liens to block these agreements. Because a short sale requires a second mortgagee's agreement to sell the home free of the lien, the second mortgagee's lien gives it a veto over the short sale. Junior lienholders thus create "hostage situations" for senior lienholders and debtors by vetoing short sales and forcing many homes into foreclosure instead. Prashant Gopal & John Gittelsohn, *Home Sales Held Hostage by Junior Lien Holders: Mortgages*, BUSINESSWEEK, July 23, 2012, *available at* http://tinyurl.com/pneq9cd. Because second mortgagees would get nothing from a sale, they have nothing to lose by holding up sales solely to extract settlements from first mortgagees. As the chief economist at Moody's Analytics explains, "'[s]ubordinate liens have become the biggest hurdle to resolving the foreclosure crisis more quickly.'" *Id.* "Second mortgages have become one of the biggest roadblocks' to short sales and the housing recovery, because junior liens often have no value except as leverage to stop deals. Nick Timiraos, *Second-Mortgage Standoffs Stand in Way of Short Sales*, WALL ST. J., Nov. 27, 2010, *available at* http://tinyurl.com/nuq2vwa; *see also* Alex Ulam, *Why Second-Lien Loans Remain a Worry*, AM. BANKER, Apr. 29, 2011, *available at* http://tinyurl.com/p65qt9m (explaining that junior lienholders "can stall or block a short sale or a loan mod[ification] that

reduces principal, and they have an incentive to do so").

Thus, while voiding partially underwater first mortgage liens may result in what could plausibly be seen as windfalls to debtors, voiding entirely underwater second mortgage liens is unlikely to do so. That is especially true where, as here, the second mortgage is deeply underwater. Instead, voiding those junior liens helps senior creditors and the housing market generally by promoting consensual resolutions as alternatives to foreclosure.

None of the courts of appeals has considered whether these crucial differences distinguish the two-creditor situation from the single-creditor situation in *Dewsnup*. Further percolation would let them do so in the first instance.

b. *Junior Creditors' Bargains Already Reflect Their Subordination to Senior Creditors.* Before the housing crash, junior mortgages (including home-equity loans and lines of credit) had high loan-to-value ratios, frequently reaching "nearly 100%." Martin Feldstein, *How to Stop the Mortgage Crisis*, WALL ST. J., Mar. 7, 2008, *available at* http://tinyurl.com/kfjr54x (not limiting this observation to second mortgages). Such junior lenders bargained for the situation that came to pass: because loan-to-value ratios were so high, any drop in home values would immediately impair the loans' value and quickly make them valueless – much faster than for first mortgages.

In other words, these mortgagees negotiated for their position subordinate to senior lienholders, "who had [every]thing to do with the mortgagor-mortgagee bargain." *Dewsnup*, 502 U.S. at 417. Even outside of bankruptcy, if a first mortgagee forecloses on a home, the foreclosure sale removes the junior lien. The most that a junior creditor may claim is that its junior (and often worthless) lien should have been removed via foreclosure, not that it held inviolable priority. As compensation for their more precarious security position, second mortgagees demanded higher interest rates and other favorable terms. In 2009, for example, borrowers paid interest rates that averaged about four percentage points higher for $30,000 home-equity loans than for 30-year mortgages.[3] Both greater rewards and greater risks, including the risk of foreclosure by first mortgagees, were part of junior creditors' bargains.

None of the courts of appeals has considered whether this crucial difference in priority distinguishes second mortgages from first mortgages under

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[3] According to Bankrate's graphs of rate trends, in November 2009, a $30,000 home-equity loan charged a 9.13% interest rate on average, compared with a 4.98% average rate for a 30-year residential mortgage. *See Graph Rate Trends*, BANKRATE, http://tinyurl.com/ohqw6vz (under "Category" select "Loans and Lines of Credit," and under "Product Type" select "30K FICO-Based High LTV Home Equity Loan." Compare the graphed results to selecting "Mortgage Loans" under "Category" and "30 Year Fixed" under "Product Type").

Dewsnup. Further percolation would let them do so in the first instance.

c. *Unlike First Mortgages, Which Had Long Passed Through Bankruptcy Unaffected, There Is No Comparable History of Second Mortgages in the Decades Before the 1978 Bankruptcy Code. Dewsnup* emphasized that for more than a century, mortgage liens had passed through bankruptcy unaffected. 502 U.S. at 419. But this long history was one of first mortgages. In the decades leading up to the 1978 Bankruptcy Code, second mortgages composed only a tiny fraction of the mortgage market, between 1.5% and 3.2%. Joyce M. Manchester & James M. Poterba, *Second Mortgages and Household Saving*, 19 REGIONAL SCI. & URB. ECON. 325, 327 tbl.1 (1989). It was not until around the time the Bankruptcy Code was enacted that state and federal legislation abolished or lifted usury caps and loan-to-value limits and permitted new loan structures – policies that encouraged the explosive growth in second mortgages.[4]

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[4] *See, e.g.*, Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, sec. 322, § 5(c)(1)(B), sec. 403, § 24, secs. 801-07, 96 Stat. 1469, 1499, 1510-11, 1545-48 (codified at 12 U.S.C. §§ 371, 1464(c)(1)(B), 3801-05) (eliminating maximum loan-to-value ratios for residential real property, lifting other prior restrictions on real estate loans, and promoting alternative mortgage transactions); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 501, 94 Stat. 132, 161-63 (codified at 12 U.S.C. § 1735f-7) (preempting state usury ceilings).

Because they were far less common than first mortgages before the 1978 Bankruptcy Code, there was no comparably settled practice of preserving *second* mortgage liens in bankruptcy. So allowing the voiding of second mortgage liens does not "effect a major change in pre-Code practice." *Dewsnup*, 502 U.S. at 419.

None of the courts of appeals has considered whether this crucial difference in historical practice distinguishes second mortgages from first mortgages under *Dewsnup*. Further percolation would let them do so in the first instance.[5]

III. This Case Is a Poor Vehicle Because It Lacks a Fully Developed Adversarial Presentation in the Lower Courts

This case is a poor vehicle for review because petitioner conceded judgment in each court below, leading to summary affirmances with little opportunity for courts to refute, or even confront, the arguments petitioner now advances. "While this Court

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[5] Petitioner's amicus in *Bank of America* v. *Caulkett* (No. 13-1421) errs in suggesting that, by allowing courts to void underwater liens, the Eleventh Circuit has rendered superfluous the right to "redeem tangible personal property" under 11 U.S.C. § 722. No. 13-1421 Amicus Br. 5-6, 11-12. Because *Dewsnup* forbids voiding partially underwater liens, a debtor who wishes to redeem his personal property from a senior lien must still use Section 722. Moreover, personal property is rarely encumbered by multiple liens and so rarely has entirely underwater liens.

decides questions of public importance, it decides them in the context of meaningful litigation." *The Monrosa* v. *Carbon Black Exp., Inc.*, 359 U.S. 180, 184 (1959). Hurried proceedings blunt the "concrete adverseness which sharpens the presentation of issues upon which the court so largely depends." *Baker* v. *Carr*, 369 U.S. 186, 204 (1962).

Here, the parties failed to develop the arguments and record in the courts below. Petitioner conceded judgment in the bankruptcy court, the district court, and the Eleventh Circuit. Though it briefed the issue in the Eleventh Circuit, it admitted that the panel was bound to follow circuit precedent and affirm the voiding of the junior lien. "There are no facts in dispute," as petitioner notes (at 21-22), only because petitioner bypassed developing or contesting the relevant facts. Indeed, even such basic facts as the original sale price, original first mortgage amount, original loan-to-value ratio, and interest rates were not part of the record below. *Supra* pp.5-6 & n.1. Because petitioner admitted defeat, Mr. Toledo-Cardona had no reason to defend the Eleventh Circuit's rule and so did not fully brief the issue. The same vehicle defect afflicted Bank of America's petition in *Sinkfield* (No. 13-700), in which this Court denied certiorari earlier this year.

The opinions below similarly reflect the lack of a significant adversarial presentation. The courts engaged in rote application of the law with no discussion of arguments or reasoning. Each opinion was unpublished, and the Eleventh Circuit panel's opinion

was unpublished and per curiam. If this Court were to proceed with this thinly developed case, it would have to do so without the benefit of the lower courts' legal analysis. A reasoned, published decision below would better inform the Court's consideration of the issues on both sides.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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As Bank of America explained in its reply in support of certiorari in *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, the decision below—holding that a chapter 7 debtor may strip off a valid junior lien on the debtor's house merely because the lien is wholly underwater—splits with every other court of appeals that has decided the question.[1] The Eleventh Circuit acknowledged it. Pet. App. 13a. And respondent admits it. Opp. 9. In the Fourth, Sixth, and Seventh Circuits such a lien cannot be stripped off; in the Eleventh Circuit it can be.

Respondent's efforts to minimize the split (at 8-10) fail. A 3-1 circuit split is not insignificant. Respondent's assertion (at 9) that the courts of appeals have not taken account of one another's opinions is incorrect. Nor is it relevant that two of the four circuits considered the question "before the financial-crisis spike in bankruptcy filings" (*id.*), unless one believes that the meaning of the Bankruptcy Code changes when the number of bankruptcy filings increases. And respondent's claim (at 8, 9) that the lien-stripping issue is "rare[]" and "not ... important" is just wrong. This issue arises daily in bankruptcy courts across the country, and Bank of America—just one servicer—has 65 lien-stripping matters pending in the Eleventh Circuit alone. *See* Pet. 18-20. Indeed, this question may be the single most important unresolved issue in consumer bankruptcy, affecting every debtor or potential debtor

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[1] The petition in *Caulkett* is identical in substance to this one (*see* Pet. 3-4), and because the debtors in both cases are represented by the same counsel, the briefs in opposition are also materially identical.

Bank of America respectfully submits that the petition in *Caulkett* should be granted and this petition held pending *Caulkett*'s disposition. In the alternative, the Court should grant this petition.

with a second mortgage and every lender who made such a loan.

Respondent's attempts to manufacture a vehicle problem also fail. All the relevant facts in this case are undisputed; the undeveloped facts respondent points to (at 20) are irrelevant—and in any case it would have been respondent's burden, as the movant, to develop them. And the Eleventh Circuit has considered the question as fully as it ever will. When this Court denied certiorari in *Bank of America, N.A.* v. *Sinkfield*, No. 13-700, there was still a possibility that the Eleventh Circuit would rehear the issue en banc. Since then, the Eleventh Circuit has denied three petitions for rehearing en banc of this issue, making clear that its decision in *McNeal* v. *GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012), is the court's last word on the subject. Certiorari was not sought in *McNeal* itself, so this case, in which the Eleventh Circuit relied on *McNeal*, is the perfect opportunity for this Court to review the issue.

Respondent's primary argument against granting certiorari is that the Eleventh Circuit's decision is correct. If true, that would be a powerful argument for *granting* certiorari, since on respondent's theory, three courts of appeals and lower courts across the country have wrongly decided this issue. Even the Eleventh Circuit, however, recognized that this Court's decision in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), "seems to reject" its reasoning. Pet. App. 14a. Indeed it does. Respondent's contrary contentions misapprehend *Dewsnup*, the Bankruptcy Code, and basic principles of statutory interpretation. But whichever side is correct on the merits, this division of authority on a critically important question must be resolved and should be resolved now.

I. Only This Court Can Resolve The Square And Acknowledged Circuit Split On A Central Issue Of Consumer Bankruptcy Law

Respondent admits (at 6, 9) that the decision below conflicts with decisions of the Fourth, Sixth, and Seventh Circuits. His efforts to minimize this square and acknowledged split are unavailing.

1. Respondent asserts (at 7, 8) that, because only a "handful of circuits" have addressed the issue, the split is "shallow and immature." That is doubly wrong.

First, since 2001, four federal courts of appeals have considered this question, and all—save one—have determined that §506(d) does not permit a debtor to void a wholly underwater lien securing an allowed claim. A 3-1 split is hardly a "paucity of circuit precedent." Opp. 8. Indeed, this Court routinely resolves bankruptcy controversies involving shallower splits. *See, e.g.*, *Baker Botts, LLP* v. *ASARCO, LLC*, 83 U.S.L.W. 3094 (U.S. Oct. 2, 2014) (No. 14-103) (granting certiorari on a 1-1 split); *Clark* v. *Rameker*, 134 S. Ct. 2242, 2246 (2014) (1-1 split); *Radlax Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065 (2012) (2-1 split). *Dewsnup* itself resolved a mere 1-1 split. 502 U.S. at 414.

Second, this issue has had more than ample time to percolate. Two of the court of appeals decisions have remained good law in their respective circuits for more than a decade. The decisions are thus "entrenched" (Opp. 9)—whether or not they were issued by en banc courts. And it is simply incorrect that "this Court does not have the benefit of any criticism or reactions by any courts of appeals to one another's opinions" (*id.*). In *In re Talbert*, 344 F.3d 555 (6th Cir. 2003), the Sixth Circuit considered the Fourth Circuit's decision in *Ryan* v.

Homecomings Financial Network, 253 F.3d 778 (4th Cir. 2001), as well as lower court decisions reaching the contrary result. Examining what, at that time, was a wider "divi[sion]" among courts, the Sixth Circuit concluded that "[w]e agree with the Fourth Circuit" that "[t]he Supreme Court's reasoning for not permitting 'strip downs' in the Chapter 7 context applies with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off.'" *Talbert*, 344 F.3d at 558, 560. The Seventh Circuit's recent decision in *Palomar* v. *First American Bank*, 722 F.3d 992 (7th Cir. 2013), likewise discussed both *Talbert* and *Ryan*. *See* 722 F.3d at 994 (noting that the holdings in those cases "are supported ... [by] *Dewsnup*"). And, finally, the Eleventh Circuit itself candidly acknowledged both *Talbert* and *Ryan*, but explained that it disagreed with those courts and would, instead, follow its pre-*Dewsnup* precedent. Pet. App. 14a-15a.[2] In short, this split will not heal itself.

2. In a similar vein, respondent argues (at 9-10) that the Fourth and Sixth Circuit ruled "before the financial-crisis spike in bankruptcy filings" and thus might reconsider if forced to grapple with "truly valueless second liens." That argument is equally weak.

Both courts of appeals held that "'the reasons articulated by the Supreme Court for its holding in *Dewsnup* ... are equally pertinent'" to wholly underwater second mortgages. *Ryan*, 253 F.3d at 783; *see Talbert*, 344 F.3d at 556. *Ryan* reached that conclusion notwithstanding that "in many cases junior lien holders may have little or no opportunity to recover." 253 F.3d

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[2] The issue is also well percolated in the lower courts, and those courts uniformly hold that *Dewsnup*'s reasoning precludes strip-offs in chapter 7 proceedings.

at 783. The likelihood of recovery, the court explained, was of no consequence because junior lienholders are "entitled to their lien position until ... [a] final disposition is had." *Id.*; *see Talbert*, 344 F.3d 561-562 (same).

Even if those decisions did not expressly repudiate respondent's argument that a "truly valueless" lien might yield a different result, the argument makes no sense—either as a matter of economics or statutory interpretation. There is no such thing as a "truly valueless" lien on property capable of appreciating; such a lien always has some option value, however small. Moreover, as a first mortgage is paid down, the equity available to a second lienholder will typically increase. In any event, the same language in the Bankruptcy Code cannot—and does not—prescribe one kind of treatment for junior liens if a senior lien is "slightly" underwater (Opp. 9) and another kind if the senior lien is deeply underwater. Courts "can[not] give the same statutory text different meanings in different cases." *Clark* v. *Martinez*, 543 U.S. 371, 386 (2005).

3. Finally, respondent's assertion (at 8, 9) that this issue arises "rarely" and is not "important" is belied by the facts described in Bank of America's petition (at 19-21)—which respondent nowhere disputes. Many hundreds of motions to strip off junior liens have been filed in bankruptcy courts in the Eleventh Circuit since *McNeal*, with 65 still pending against Bank of America alone. And underwater junior mortgages affect chapter 7 proceedings nationwide. At the end of the second quarter of 2014, by one count, about 2.1 million borrowers had partly or wholly underwater junior mortgages.[3]

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[3] CoreLogic, *Equity Report, Second Quarter 2014* at 5, *available at* http://www.corelogic.com/research/negative-equity/corelogic-q2-2014-equity-report.pdf.

This issue potentially affects them all—as well as all their lenders. There is perhaps no more important unresolved issue in consumer bankruptcy than this one.

II. This Case Is An Ideal Vehicle To Decide The Question Presented

Respondent's attempt (at 19-21) to conjure up vehicle problems is likewise meritless.

As respondent acknowledges (at 20), there are no facts in dispute. That makes this an ideal vehicle for certiorari, since the legal question on which the courts of appeals have divided is cleanly presented. Respondent asserts that Bank of America "bypassed developing or contesting the relevant facts," but fails to explain how facts such as the "original loan-to-value ratio" have any bearing on the legal question. And even if such facts were somehow relevant, it is respondent, as the movant, who had the burden to develop them. Respondent should not be heard to oppose certiorari on the ground that he failed to make an adequate record below.[4]

Nor is it grounds for denying certiorari that Bank of America "admitted" that the Eleventh Circuit panel and lower courts were bound by circuit precedent—while preserving its right to appeal—or that the panel so held (*see* Opp. 20-21). The courts below *were* bound by *McNeal*. It would have been odd indeed if the Bank did not "admit[]" that, or the courts did not say so. And the "discussion of arguments or reasoning" that respondent finds lacking in the decisions below is con-

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[4] Respondent likewise cannot reasonably complain that the appeal was not "fully brief[ed]" (Opp. 20) where *respondent* filed no brief. The Bank both briefed its position that *McNeal* was wrongly decided and moved for initial hearing en banc, which the court of appeals denied. *See* Pet. 11.

tained in *McNeal* and in *Folendore* v. *Small Business Administration*, 862 F.2d 1537 (11th Cir. 1989), the pre-*Dewsnup* decision on which *McNeal* relied. Respondent's position would appear to be that, now that this Court can no longer review *McNeal* itself, it can *never* review this question, since all future Eleventh Circuit panels—like the panel below—will be bound by *McNeal* and will presumably say so. That is plainly wrong.[5]

Finally, to the extent respondent is contending that the Eleventh Circuit has not had the opportunity fully to consider the question presented here, that contention is also wrong. The lender in *McNeal* filed a petition for en banc rehearing, and the Eleventh Circuit considered that petition for two years—during which time many hundreds of lien-strip motions were filed within the circuit, and lower courts repeatedly and unsuccessfully urged the Eleventh Circuit to take action. Pet. 21.[6] Ultimately, in May 2014, the court of appeals denied rehearing in *McNeal*. The court later denied two additional petitions for rehearing—including one by Bank of America—that had been filed while the petition in *McNeal* was pending. Order, *Wilmington Trust, N.A.* v. *Malone*, No. 13-13688 (July 16, 2014);

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[5] "[T]hat a federal court of appeals acts summarily" or "order[s] that its opinion not be published" is "no bar to Supreme Court review." Shapiro et al., *Supreme Court Practice* 82 (10th ed. 2013). This Court regularly reviews such cases. *See, e.g.*, *Octane Fitness, LLC* v. *Icon Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014) (reviewing court of appeals' summary affirmance of district court's ruling); *Ricci* v. *DeStefano*, 557 U.S. 557 (2009) (reviewing court of appeals' one-paragraph decision).

[6] During that period, this Court denied certiorari in *Bank of America, N.A.* v. *Sinkfield*, 134 S. Ct. 1760 (Mar. 31, 2014). Since then, the Eleventh Circuit has denied rehearing on this issue three times. Any prudential concerns that might have led this Court to deny review in *Sinkfield* thus no longer exist.

Order, *Bank of America, N.A.* v. *Bello*, No. 14-10062 (June 17, 2014). Every effort has been made to persuade the Eleventh Circuit to reconsider *McNeal*, and it has refused to do so.

III. THE DECISION BELOW IS WRONG

Respondent's main argument for denying certiorari is that the Eleventh Circuit's decision is correct. As noted, if that were true, it would be a reason to *grant* certiorari, not to deny it. In any event, the Eleventh Circuit's decision is wrong. It cannot be reconciled with *Dewsnup*—as the court of appeals itself all but admitted (*see* Pet. App. 14a). Respondent's contrary arguments fail.

1. Respondent contends (at 11-14) that *Dewsnup*'s reasoning was limited to partially underwater first mortgages, not wholly underwater second mortgages. Respondent is mistaken.

Section 506(d) of the Bankruptcy Code provides that "[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void." Against the backdrop of pre-Code law, under which liens passed through bankruptcy unaffected, *Dewsnup* construed the phrase "'allowed secured claim'" "term-by-term to refer to any claim that is, first, allowed, and, second, secured." 502 U.S. at 415; Pet. 7-8. So understood, an "allowed secured claim" is nothing more than a valid claim "secured by a lien with recourse to the underlying collateral." *Id.* *Dewsnup* thus held that liens may be voided under §506(d) only "when[] [the] *claim* secured by the lien ... has not been allowed," never merely because the value of the collateral has decreased. *Id.* at 416 (emphasis added).

Dewsnup did not conclude, as respondent suggests (at 13), that the loan in that case was "secured" for purposes of §506(d) because the collateral still retained some value. The holding in *Dewsnup* was much simpler: For purposes of §506(d), a claim is "secured" if it is "secured by a lien," regardless of the value of the collateral. 502 U.S. at 414-415. The collateral's value is relevant only to the treatment of the creditor's *claim* under §506(a): To the extent that the creditor's claim exceeds the value of the collateral, the deficiency is treated as an unsecured claim. The collateral's value has no effect on the treatment of the creditor's *lien* under §506(d)—regardless of whether the lien is first-, second-, or third-priority, and regardless of the extent to which it is underwater. "[T]he creditor's lien," consistent with more than a century of bankruptcy principle and practice, "stays with the real property until the foreclosure." *Dewsnup*, 502 U.S. at 417.

2. Respondent contends (at 18-19) that that basic principle does not apply to second mortgages. But *Dewsnup* allows no such distinction. Rather, it explains that "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." 502 U.S. at 418-419. Respondent adduces no evidence of contrary pre-Code practice for junior liens. Nor could he, because the principle identified in *Dewsnup* governs the treatment of security interests in general and is rooted in constitutional concerns. *See id.* at 418-419; *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 594 (1935). A lienholder's rights—to be paid in full or to take whatever collateral is available—are the same regardless of the lien's priority.

3. Respondent's "policy" arguments fare no better. *Dewsnup*'s "primary rationale" was not "prevent-

ing windfalls to debtors" (Opp. 13). It was the long-established principle that liens ride through bankruptcy and the conclusion that the Code did not alter lienholders' rights in that respect.

In any event, *Dewsnup's* observation that lien-stripping results in a "windfall" to the debtor if the property later appreciates in value applies equally to junior liens. To be sure, such appreciation will benefit an underwater senior lienholder first, but that misses the point. Stripping a lien down to the value of its collateral deprives the lienholder of the benefit of his bargain—that is, the right to benefit from any subsequent increase in value, which "rightly accrues to the benefit of the [secured] creditor," not the debtor or unsecured creditors. *Dewsnup*, 502 U.S. at 417.

Similarly, respondent observes (at 17) that junior lienholders "negotiated for their position subordinate to senior lienholders." It is indeed the case that junior lienholders are junior to senior lienholders. But that truism hardly answers the question whether junior lienholders' interests should be "subordinate" to the interests of unsecured creditors and the debtor. And *Dewsnup* makes clear that junior lienholders are entitled to the benefit of their bargain in that regard.

Finally, respondent argues (at 14-16) that stripping off junior liens would have a salutary effect on the housing market because it would prevent junior lienholders from exercising their right to object to a short sale. This argument fails on multiple levels. As an initial matter, lien-stripping in bankruptcy would not solve the alleged problem. A short sale is a way of modifying a borrower's debt *outside* bankruptcy. In chapter 7, the debtor may surrender the property, in which case it is sold, the creditors recover what they

can, and the debtor's remaining debt is discharged. *See* 11 U.S.C. §§704(a)(1), 725, 727(b). It is not necessary to strip off junior liens to get to that result; lien-stripping is meaningful only if the debtor keeps the property.

More fundamentally, however admirable it may be to "promot[e] consensual resolutions as alternatives to foreclosure" (Opp. 16), neither the Bankruptcy Code nor this Court's precedent permits stripping off junior liens to achieve that aim.

CONCLUSION

The petition for a writ of certiorari in *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, should be granted and this petition held pending that case's disposition. In the alternative, the petition in this case should be granted.

Respectfully submitted.

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IN THE

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EDELMIRO TOLEDO-CARDONA,

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Section 506(d) of the Bankruptcy Code provides in relevant part that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court held that §506(d) does not permit a chapter 7 debtor to "strip down" a mortgage lien to the current value of the collateral. The question presented in this case is whether §506(d) permits a chapter 7 debtor to "strip off" a junior mortgage lien in its entirety when the outstanding debt owed to a senior lienholder exceeds the current value of the collateral.

CORPORATE DISCLOSURE STATEMENT

Petitioner Bank of America, N.A. is a wholly owned subsidiary of Bank of America Corporation, a publicly traded corporation (ticker symbol: BAC). Bank of America Corporation has no parent corporation, and no publicly held corporation holds 10% or more of its stock.

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OPINIONS BELOW

In *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, the court of appeals' order affirming the district court is unpublished and appears at Pet. App. 1a-2a. The district court's order affirming the bankruptcy court is unpublished and appears at Pet. App. 3a. The bank-

ruptcy court's order is unpublished and appears at Pet. App. 5a-7a.

In *Bank of America, N.A.* v. *Toledo-Cardona*, No. 14-163, the court of appeals' order affirming the district court is unpublished and appears at Pet. App. 1a-3a. The district court's order affirming the bankruptcy court is unpublished and appears at Pet. App. 5a-6a. The bankruptcy court's order is unpublished and appears at Pet. App. 7a-9a.

JURISDICTION

In *Caulkett*, the Eleventh Circuit entered its judgment affirming the district court on May 21, 2014. Pet. App. 1a-2a. In *Toledo-Cardona*, the Eleventh Circuit entered its judgment affirming the district court on May 15, 2014. Pet. App. 1a-3a. The petitions for a writ of certiorari were filed on May 23, 2014, and August 13, 2014, respectively. This Court granted certiorari and consolidated the cases on November 17, 2014. The Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

Section 506 of the Bankruptcy Code provides in relevant part:

> (a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.
>
> ...

> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. §506. The entire text of §506, along with other relevant statutory provisions, is included in the addendum to this brief.

INTRODUCTION

In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court held that when property securing a loan is worth less than the debt owing on the loan—that is, the loan is "underwater"—the Bankruptcy Code does not permit a chapter 7 debtor to "strip down" the lien to the current value of the property. In doing so, the Court construed §506(d) of the Code to void a lien only when the underlying right to payment the lien secures is invalid. *Id.* at 417. Section 506(d), the Court held, does *not* reduce liens to the current value of the collateral: It is simply "not plausible" that Congress intended to grant debtors that "broad new remedy ... without [its] being mentioned somewhere in the Code itself or in the annals of Congress." *Id.* at 420. Rather, under chapter 7 of the Bankruptcy Code as under more than a century of pre-Code practice, liens securing valid claims "pass through bankruptcy unaffected." *Id.* at 417.

Dewsnup was decided in the context of a *partially* underwater lien. The question presented here is

whether a chapter 7 debtor may strip off a *wholly* underwater lien—specifically, a junior mortgage on a house worth less than the debt outstanding on the senior mortgage. Every court of appeals to address the question—except the Eleventh Circuit below—has held that, under *Dewsnup*, the answer is no. And, under *Dewsnup*, that is the only possible answer. *Dewsnup* held that in chapter 7, liens securing valid claims stay with the property until foreclosure or until the debt is paid in full. 502 U.S. at 417. As a commonsense matter, that is true whether the value of the collateral at the time of the bankruptcy is $1 million, one cent, or zero. "[A]ny increase in the value of the property" before foreclosure "rightly accrues to the benefit of the creditor." *Id.* In fact, that is what it means to have a lien.

The Eleventh Circuit nowhere identified any logical or doctrinal distinction between partially and wholly underwater liens that could support its contrary holding. Instead, the panel merely invoked the rule that "'a later panel may depart from an earlier panel's decision only when [an] intervening Supreme Court decision is "clearly on point,"'" and then asserted without analysis that *Dewsnup* is not "clearly on point" in a case involving an entirely underwater lien. *Caulkett* Pet. App. 12a. The court thus followed its own pre-*Dewsnup* precedent holding that §506(d) voids underwater liens, even while acknowledging that "the Supreme Court's reasoning in *Dewsnup* seems to reject" that precedent. *Id.*

As the Eleventh Circuit itself all but admitted, its decision cannot be reconciled with *Dewsnup*. This Court need go no further to resolve this case. Should respondents or their amici urge the Court to revisit *Dewsnup*, however, the Court should refuse the invitation. Not only was *Dewsnup* correctly decided, but in

the twenty years since, Congress has repeatedly acquiesced in *Dewsnup*'s interpretation of the statute.

STATEMENT

I. LEGAL BACKGROUND

A. The Two Components Of A Home Mortgage

This case involves the treatment of home mortgage loans in chapter 7 bankruptcy proceedings. A typical home mortgage has two components: a note—a document in which the homeowner promises to repay the lender—and a lien or deed of trust securing that promise. The lien is a property interest in the house under which the lender has the right to foreclose on the house if the homeowner defaults on his or her obligations under the note. The right to repayment from the homeowner and the right to foreclose on the house in the event of default are two distinct legal interests. The right to repayment runs against the borrower personally, while the right to foreclose in the event of default is an *in rem* interest in the house itself. *See generally Johnson* v. *Home State Bank*, 501 U.S. 78 (1991).

Both outside and inside bankruptcy, the lender's right to pursue the borrower *in personam* for repayment on the loan is different, and is treated differently, than the lender's *in rem* right to foreclose on the house in the event of default. *See* 4 *Collier on Bankruptcy* ¶506.06[4][a] (16th ed. 2014). As discussed in detail below, the Bankruptcy Code treats the lender's right to repayment from the debtor as a "claim." 11 U.S.C. §101(5). The lender's property interest in the house, by contrast, is a "lien." *Id.* §101(37). The Code consistently distinguishes between the two rights. For instance, a mortgage lender's prebankruptcy claim—its right to payment from the debtor personally—may be dis-

chargeable in a chapter 7 bankruptcy. By contrast, the lender's lien survives discharge in a chapter 7 case, and can be asserted against the house after bankruptcy if the debtor is in default on the note. *See Johnson*, 501 U.S. at 84. The distinction between a creditor's claim and its lien is a key feature of the architecture of the Bankruptcy Code and is critical to this case.

B. Chapter 7 Bankruptcy

1. "Chapter 7 of the Bankruptcy Code gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors." *Law* v. *Siegel*, 134 S. Ct. 1188, 1192 (2014). The filing of a chapter 7 petition creates a bankruptcy estate, which includes substantially "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. §541(a)(1). An individual debtor may, however, exempt certain property from the bankruptcy estate, thereby shielding it from creditors. *Id.* §522; *see Law*, 134 S. Ct. at 1192. A chapter 7 petition also triggers the appointment of a chapter 7 trustee, whose duties include "collect[ing] and reduc[ing] to money the property of the estate," 11 U.S.C. §704(a)(1), and distributing the proceeds to creditors, *id.* §726.

Once a bankruptcy petition is filed, an automatic stay takes effect, barring creditors from attempting to enforce or collect prepetition claims against the debtor or the estate. 11 U.S.C. §362(a). The automatic stay halts the proverbial race to the courthouse, which would otherwise result in first-come, first-served treatment of unsecured creditors. *See, e.g., id.* §362(a)(1). It also temporarily prevents secured creditors such as mortgage lenders from exercising their right to foreclose on their collateral in the event of default. *See, e.g., id.* §362(a)(4). The automatic stay

thereby ensures that the trustee can marshal and liquidate all the estate's property without competition from creditors and distribute that property to creditors equitably and in accordance with their lawful priority. *See* 3 *Collier on Bankruptcy* ¶362.03.

A prepetition creditor may assert its right to payment from the estate by filing a proof of claim. 11 U.S.C. §501(a). The claim is deemed "allowed"—that is, valid—unless a party in interest objects. *Id.* §502(a). If a party in interest does object, the court determines, after notice and hearing, whether to allow the claim. *Id.* §502(b). Such claims are allowed unless they are "unenforceable against the debtor ... under any agreement or applicable [non-bankruptcy] law," *id.* §502(b)(1), or fall into certain other narrowly defined categories, *id.* §502(b)(2)-(9), in which case they are "disallowed." "Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation," *Raleigh* v. *Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000), and bankruptcy courts must therefore "consult state law in determining the validity of most claims," *Travelers Cas. & Sur. Co. of Am.* v. *Pacific Gas & Elec. Co.*, 549 U.S. 443, 450 (2007).

Creditors with allowed claims are entitled to receive a distribution from the estate. The treatment of a claim depends, in the first instance, on whether the claim is secured by a lien with recourse to collateral. Creditors with a lien on particular property have the first right to the proceeds of that property; if there is more than one such creditor, creditors holding liens that are senior under applicable nonbankruptcy law recover before creditors holding junior liens. As discussed in more detail below, *see infra* pp.10-11, if a lienholder's collateral is insufficient to satisfy its al-

lowed claim (that is, the claim is undersecured), the lienholder may assert an unsecured claim for the deficiency. 11 U.S.C. §506(a).

Only property of the estate that remains after satisfaction of secured claims is available for distribution to those holding unsecured claims. If any such property exists, holders of unsecured claims receive a pro rata distribution from that property in accordance with their statutory priority. 11 U.S.C. §726(a); *see id.* §507(a) (granting priority to certain unsecured claims).

At the end of the case, an individual chapter 7 debtor will typically receive a discharge of most prepetition debts. *See* 11 U.S.C. §§524, 727.[1] That is, a prepetition creditor will no longer have the right to collect such a debt from the debtor, whether or not the creditor has received any distribution from the estate. The discharge "operates as an injunction against the commencement or continuation of an action ... to collect ... any such debt as a personal liability of the debtor." *Id.* §524(a)(2).

As the wording of §524 indicates, however, a chapter 7 proceeding discharges only the debtor's personal liability on his or her debts; it does not affect a secured creditor's nonbankruptcy right to enforce its lien. *See Johnson*, 501 U.S. at 84 (the chapter 7 discharge "extinguishes only one mode of enforcing a [right to payment]—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*"). Thus, if a debtor keeps his or her house after chapter 7 bankruptcy, a prepetition

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[1] The debtor may be denied a discharge for certain misconduct, 11 U.S.C. §727(a), and certain debts are nondischargeable, *id.* §523(a).

mortgage lender can still foreclose on the house if the debtor defaults on the loan, even though the lender cannot pursue the debtor personally for any deficiency remaining after foreclosure. *See id.* at 86 ("[T]he mortgage interest that passes through a Chapter 7 liquidation is enforceable only against the debtor's property" and "has the same properties as a nonrecourse loan.").

2. In practice, the vast majority of individual chapter 7 cases are so-called "no asset" cases—cases in which the trustee does not collect any funds for distribution to creditors with unsecured claims.[2] After subtracting the assets they are entitled to exempt from the estate under §522, individual chapter 7 debtors typically have no property that is unencumbered by a lien remaining for distribution.

In particular, many chapter 7 debtors who own houses have no equity in them because the houses are worth less than the amount outstanding on the mortgage loans they secure—that is, the loans are undersecured or "underwater." In such cases, because there is no value in the house that can be distributed to creditors with unsecured claims, the chapter 7 trustee typically will not sell the house. Rather, the trustee will

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[2] *See Colonial Sur. Co.* v. *Weizman*, 564 F.3d 526, 531 (1st Cir. 2009) ("'Most chapter 7 cases involving individual debtors are no asset cases.'" (quoting Administrative Office of the United States Courts, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx)); Flynn, *Chapter 7 Asset Cases and Trustee Compensation*, 33 Am. Bankr. Inst. J. 48, 48 tbl. 1 (June 2014), *available at* http://journal.abi.org/sites/default/files/2014/april/numbers.pdf (between 2006 and 2011, only 7.9% of chapter 7 cases were closed as asset cases); Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 Am. Bankr. Inst. L. Rev. 17, 68 (2012) (finding that 89.4% of chapter 7 cases filed after the 2005 Bankruptcy Code amendments were no-asset cases).

"abandon" the house to the debtor. *See* 11 U.S.C. §554(a) (providing that "the trustee may abandon any property of the estate that is burdensome ... or ... of inconsequential value"); *id.* §554(c) (property included in debtor's schedules but not administered is deemed abandoned upon closing of case). "'Property abandoned under §554 reverts to the debtor, and the debtor's rights to the property are treated as if no bankruptcy petition was filed.'" *Kane* v. *National Union Fire Ins. Co.*, 535 F.3d 380, 385 (5th Cir. 2008).

When the trustee abandons the debtor's house, the lender has the same rights under its lien as it had before the bankruptcy. If the debtor is in default on the mortgage loan, the lender may foreclose on the house. Alternatively, if the debtor is current on the mortgage, he or she may stay in the house and continue to pay the mortgage following the chapter 7 proceeding. That is not uncommon: A debtor who is current on his or her mortgage may nonetheless file for chapter 7 protection in order to discharge unsecured debt such as credit-card balances or medical bills, knowing that if the house is underwater it will not be sold to pay unsecured creditors.

C. Section 506 And *Dewsnup*

As noted above, the Bankruptcy Code contains special provisions dealing with secured claims. Most importantly here, §506 of the Code ("Determination of secured status") contains four distinct provisions relating to the allowance and valuation of secured claims.

Section 506(a) addresses undersecured claims—claims secured by property whose value is less than the outstanding debt. It provides:

> An allowed claim of a creditor secured by a lien on [estate] property ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.

11 U.S.C. §506(a)(1).

In plain English, §506(a) splits an undersecured claim into two parts: a "secured claim" in the amount of the current value of the collateral and an "unsecured claim" for the remainder. That division controls the distribution a creditor can obtain from the estate. For example, a senior mortgage lender owed $150,000 on a loan secured by a house currently worth $100,000 would, for distribution purposes, have a "secured claim" for $100,000 and an "unsecured claim" for $50,000. A junior lender owed $25,000 on a loan secured by the same house would, for distribution purposes, have only an "unsecured claim" for $25,000.[3] Because secured claims are paid before unsecured claims, a creditor might recover its "secured claim" in full, but only cents on the dollar (or nothing) on its "unsecured claim."

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[3] The §506(a) valuation matters primarily in reorganization cases, in which, to confirm a plan, the debtor must pay a non-consenting secured creditor at least the value of its secured claim as determined under §506(a). *See* 11 U.S.C. §1129(b)(2)(A)(i) (chapter 11 reorganizations); *id.* §1325(a)(5)(B) (chapter 13 wage-earner plans). In no-asset chapter 7 liquidations, a §506(a) valuation is unnecessary because there will be no distribution to creditors with unsecured claims in any event, and property encumbered by a lien greater than the property's value will typically be abandoned, with the lienholder left to its state-law remedies.

Section 506(b) addresses *over*secured claims, providing that holders of such claims are entitled to interest on the claims and "reasonable fees, costs or charges" provided by the agreement or statute under which the claim arose. 11 U.S.C. §506(b).

Section 506(c) permits the trustee to recover from property securing an allowed claim "the reasonable, necessary costs and expenses" of preserving or disposing of the property for the secured creditor's benefit. 11 U.S.C. §506(c).

Finally, §506(d)—the provision at issue in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), and in this case—provides that, subject to two exceptions, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. §506(d).[4]

Before *Dewsnup*, some courts—including the Eleventh Circuit—had read §506(d) to provide that an undersecured creditor's lien is stripped down to the current value of the collateral securing the creditor's claim. *See, e.g.*, *Gaglia* v. *First Fed. Sav. & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1989); *In re Folendore*, 862 F.2d 1537 (11th Cir. 1989). Those courts reasoned that because §506(a) bifurcates undersecured claims into a secured

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[4] Both exceptions cover claims that are disallowed for reasons other than the claim's invalidity under applicable nonbankruptcy law. The first exception covers claims "disallowed only under section 502(b)(5) or 502(e) of this title." 11 U.S.C. §506(d)(1). (Section 502(b)(5) disallows unmatured claims for domestic support obligations. *Id.* §§502(b)(5), 523(a)(5). Section 502(e) disallows contingent claims for reimbursement or contribution by entities that are co-liable with the debtor on a creditor's claim. *Id.* §502(e).) The second exception covers any claim that is "not an allowed secured claim due only to the failure ... to file a proof of ... claim." *Id.* §506(d)(2).

and an unsecured portion based on the value of the collateral, the unsecured portion was not an "allowed secured claim" within the meaning of §506(d), and "to the extent that" a lien's value exceeded the portion of the claim treated as secured under §506(a), it was therefore void. *Gaglia*, 889 F.2d at 1306-1308; *Folendore*, 862 F.2d at 1538-1539.

In *Dewsnup*, however, this Court soundly rejected that reading of §506(d). The Court explained that under pre-Code practice, "liens pass[ed] through bankruptcy unaffected." *Dewsnup*, 502 U.S. at 417. "Apart from reorganization proceedings, ... no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Id.* at 418-419. "Congress must have enacted the Code with a full understanding of this practice." *Id.* at 419. Reading §506(d) against that backdrop, and finding no indication in the legislative history of the Bankruptcy Code that Congress intended such a radical change in pre-Code practice, the Court concluded that §506(d) "voids only liens corresponding to claims that have *not* been allowed." *Id.* at 415 (describing creditors' position); *see id.* at 417 (adopting that position). Where a claim has been "'allowed' pursuant to §502 of the Code and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of §506(d)," regardless of the collateral's current value. *Id.* at 415; *see id.* at 417. Put differently, the value of collateral securing a debt affects only the treatment of the creditor's *claim* against the chapter 7 estate. It does not affect the validity of the creditor's *lien*.

D. The Eleventh Circuit's Decision In *McNeal*

Dewsnup involved what in bankruptcy jargon is called a "strip down"—that is, the creditor's mortgage was only partially, not completely, underwater. Nevertheless, following *Dewsnup*, virtually every court to address the issue has concluded that *Dewsnup*'s reasoning is equally applicable to "strip offs"—cases in which a mortgage is completely underwater, typically because a senior lienholder is undersecured. *See, e.g.*, *Palomar* v. *First Am. Bank*, 722 F.3d 992 (7th Cir. 2013); *In re Talbert*, 344 F.3d 555 (6th Cir. 2003); *Ryan* v. *Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001).[5]

The Eleventh Circuit is the only court of appeals to have reached the opposite conclusion. In 1989, before *Dewsnup*, the Eleventh Circuit held that §506(d) voids a creditor's completely underwater junior lien. *Folendore*, 862 F.2d at 1538-1539. *Folendore* reasoned that, under §506(a), no part of such a creditor's claim is "secured" and therefore it is not an "allowed secured claim" within the meaning of §506(d). *See id.*

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[5] *See also Wachovia Mortg.* v. *Smoot*, 478 B.R. 555 (E.D.N.Y. 2012); *In re Cook*, 449 B.R. 664 (D.N.J. 2011); *In re Richins*, 469 B.R. 375 (Bankr. D. Utah 2012); *In re Bowman*, 304 B.R. 166 (Bankr. M.D. Pa. 2003); *In re Fitzmaurice*, 248 B.R. 356 (Bankr. W.D. Mo. 2000); *but see In re Lavelle*, 2009 WL 4043089 (Bankr. E.D.N.Y. Nov. 25, 2009). A handful of other lower courts outside the Eleventh Circuit initially ruled that *Dewsnup* did not apply to strip-offs, but those decisions have been overruled or reversed. *See, e.g.*, *In re Farha*, 246 B.R. 547 (Bankr. E.D. Mich. 2000), *overruled by Talbert*, 344 F.3d 555; *In re Zempel*, 244 B.R. 625 (Bankr. W.D. Ky. 1999), *overruled by Talbert*, 344 F.3d 555; *In re Yi*, 219 B.R. 394 (E.D. Va. 1998), *overruled by Ryan*, 253 F.3d 778; *In re Smoot*, 465 B.R. 730 (Bankr. E.D.N.Y. 2011), *rev'd*, 478 B.R. 555 (E.D.N.Y. 2012).

In the two decades between 1992 and 2012, lower courts within the Eleventh Circuit uniformly concluded that *Dewsnup* had repudiated *Folendore*'s reasoning, and that strip-offs were indistinguishable from strip-downs under *Dewsnup*'s logic.[6] But on May 11, 2012, in *In re McNeal*, 735 F.3d 1263, a panel of the Eleventh Circuit concluded that, notwithstanding *Dewsnup*, *Folendore* was still binding precedent until overturned by the en banc court. *Caulkett* Pet. App. 11a-13a.

The *McNeal* panel candidly acknowledged that *Dewsnup* "seems to reject the plain language analysis that we used in *Folendore*." *Caulkett* Pet. App. 12a. But, invoking the Eleventh Circuit's "'prior panel precedent rule,'" under which "'a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is clearly on point,'" the panel concluded that it was bound by *Folendore* even after *Dewsnup*. *Id.* "Because *Dewsnup* disallowed only a 'strip down' of a partially secured mortgage lien and did not address a 'strip off' of a wholly unsecured lien, it is not 'clearly on point' with the facts in *Folendore* or with the facts at issue in this appeal." *Id.*

The mortgage servicer in *McNeal* sought en banc rehearing of the panel's decision. Over two years later, the Eleventh Circuit denied the petition for rehearing. *Caulkett* Pet. App. 15a-16a.

McNeal has had a profound impact. When it was decided in 2012, more than 20 million borrowers in the United States had outstanding second liens, totaling

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[6] *See, e.g.*, *In re Armstrong*, 2011 WL 768080, at *2-3 (M.D. Fla. Feb. 28, 2011); *In re Hoffman*, 433 B.R. 437, 440 (Bankr. M.D. Fla. 2010); *In re Woods*, 2004 WL 5848051, at *3 (Bankr. N.D. Ga. June 17, 2004); *In re Cater*, 240 B.R. 420, 423 (M.D. Ala. 1999).

over $800 billion.[7] And the financial crisis that began in 2008, bringing with it massive declines in home values, had left many of those mortgages underwater. Although the housing market subsequently took an upturn, as of the middle of 2012, the junior mortgages of approximately 4.2 million borrowers were still partially or wholly underwater.[8] As two local practitioners put it, "[t]he significance of *McNeal* can hardly be [over]stated, especially in this depressed real estate market" because "numerous properties subject to multiple mortgage liens are worth less than the amount of the first-priority mortgage."[9]

Indeed, since its issuance, *McNeal* has precipitated thousands of motions and complaints to strip off wholly underwater junior liens in bankruptcy courts in the Eleventh Circuit. Hundreds of such proceedings have been brought against Bank of America alone.

At the same time, the housing market has been rebounding, and as home values increase, underwater liens are regaining equity. Between June 2012 and June 2014, the number of U.S. borrowers with partially or wholly underwater junior mortgages was cut in half,

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[7] Lee et al., *A New Look at Second Liens*, in *Housing and the Financial Crisis* 212, 213 (Glaeser & Sinai eds. 2013) (figures as of the first quarter of 2012).

[8] CoreLogic, *CoreLogic Reports Number of Residential Properties in Negative Equity Decreases Again in Second Quarter of 2012* (Sept. 12, 2012), *available at* http://www.corelogic.com/about-us/news/corelogic-reports-number-of-residential-properties-in-negative-equity-decreases-again-in-second-quarter-of-2012.aspx.

[9] Bruce & Popowitz, *Get Busy Stripping Until The Eleventh Circuit Says Otherwise*, 2 S.D. Fla. Bankr. Bar Ass'n J. 9 (2013).

falling to 2.1 million.[10] The total number of underwater homes, including those without junior mortgages, also fell dramatically, from 10.8 million to 5.3 million.[11] And the recovery is continuing. In the second quarter of 2014 alone, about 946,000 homes regained sufficient value that they were no longer underwater.[12] Junior liens that are completely underwater at the time of a debtor's bankruptcy may thus quickly acquire significant value.

II. Proceedings Below

The two consolidated cases before this Court are two of the many proceedings to strip wholly underwater junior liens that debtors have brought against Bank of America in the Eleventh Circuit after *McNeal*.

Respondents David Caulkett and Edelmiro Toledo-Cardona have loans from Bank of America secured by second liens on their respective houses. *Caulkett* Pet. App. 5a-6a; *Toledo-Cardona* Pet. App. 2a. There has never been any dispute that Bank of America's liens are valid and enforceable under state law.

Caulkett and Toledo-Cardona filed chapter 7 petitions in the U.S. Bankruptcy Court for the Middle District of Florida in 2013. Each had two mortgages on his house, and in each case it was undisputed that the outstanding balance on the first mortgage loan exceeded the house's then-current value. Respondents filed motions to strip off Bank of America's junior liens under

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[10] CoreLogic, *Equity Report, Second Quarter 2014*, at 5 (2014), *available at* http://www.corelogic.com/research/negative-equity/corelogic-q2-2014-equity-report.pdf.

[11] *Id.* at 9.

[12] *Id.* at 3.

§506(d). *Caulkett* Pet. App. 5a-6a; *Toledo-Cardona* Pet. App. 2a.[13]

Respondents' motions were filed after the panel decision in *McNeal* but before the Eleventh Circuit had denied rehearing. Accordingly, in each case, Bank of America responded to the debtor's motion by acknowledging that, under *McNeal*, the debtor was entitled to strip off the lien, but reserving its right to seek appellate review. In each case, the bankruptcy court granted the debtor's motion and ordered that Bank of America's second lien would be void upon the debtor's receipt of a chapter 7 discharge. *Caulkett* Pet. App. 5a-6a; *Toledo-Cardona* Pet. App. 7a-8a. In each case, the debtor received a chapter 7 discharge. *Caulkett*, No. 13-5537, Dkt. 15 (Bankr. M.D. Fla. Aug. 16, 2013); *Toledo-Cardona*, No. 13-5393, Dkt. 15 (Bankr. M.D. Fla. July 30, 2013).

Bank of America appealed both rulings to the district court, where—in light of *McNeal*—the Bank filed motions for summary affirmance, again expressly reserving its right to seek further appellate review. In each case, the district court entered an order summarily affirming the bankruptcy court. *Caulkett* Pet. App. 3a; *Toledo-Cardona* Pet. App. 5a. Bank of America timely appealed both of the district court orders to the court of appeals.

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[13] Caulkett's motion asserted that his house was worth $98,000 and that the amounts outstanding on the first and second mortgages were $183,264 and $47,855, respectively. *Caulkett*, No. 13-5537, Dkt. 26 (Bankr. M.D. Fla. Sept. 24, 2013). Toledo-Cardona's motion asserted that his house was worth $77,689 and that the amounts outstanding on the first and second mortgages were $135,703 and $32,000, respectively. *Toledo-Cardona*, No. 13-5393, Dkt. 8 (Bankr. M.D. Fla. June 7, 2013).

On appeal, Bank of America filed briefs setting out its arguments that *Folendore* and *McNeal* were wrongly decided, while acknowledging that the panels were bound by those decisions and reserving its right to seek rehearing en banc or certiorari. In *Toledo-Cardona*, Bank of America also requested that the en banc court hear the matter in the first instance. On May 15, 2014, the court denied that request and issued a brief per curiam decision in *Toledo-Cardona* holding that it was "bound as a panel to follow our Court's decision in *McNeal*." *Toledo-Cardona* Pet. App. 3a; Order, No. 13-15855 (11th Cir. May 15, 2014).

On May 20, 2014, the Eleventh Circuit declined to rehear *McNeal* en banc. *Caulkett* Pet. App. 15a. The next day, a panel of the Eleventh Circuit issued a brief per curiam decision in *Caulkett* holding that, under *McNeal*, "a wholly unsecured junior lien—such as the one held here by Bank of America—is voidable under section 506(d)." *Id.* 2a.

Bank of America sought certiorari in both cases, and on November 17, 2014, this Court granted certiorari and consolidated the two cases for briefing and argument.

SUMMARY OF ARGUMENT

I. *Dewsnup* does not permit the strip-off of wholly underwater junior liens. *Dewsnup* held, in a nutshell, that §506(d) strips only liens securing *disallowed* claims—essentially, claims that are invalid under nonbankruptcy law. Where a claim "has been 'allowed' ... and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of §506(d)." *Dewsnup* v. *Timm*, 502 U.S. 410, 415 (1992); *see id.* at 417. That analysis applies with equal force to *any*

lien—whether it is junior or senior or partially or wholly underwater. Bank of America's junior mortgage loans are valid claims and are secured by liens with recourse to the underlying collateral. Accordingly, §506(d) provides no basis for stripping the liens. Likewise, the pre-Code practice on which *Dewsnup* relied to prohibit the strip-down of partially underwater senior liens is just as compelling in the case of wholly underwater junior liens.

II. Moreover, there is no reason for this Court to revisit *Dewsnup*—and good reason it should not do so. *Dewsnup* was correctly decided. As an initial matter, the context and structure of §506 itself—along with its drafting and legislative history—make clear that it is primarily directed to the treatment of secured *claims*, not to the treatment of *liens*. Section 506(d) invalidates liens securing disallowed, invalid claims simply in order to ensure that the disallowance has full effect outside bankruptcy. Moreover, the Bankruptcy Code addresses lien-stripping elsewhere, in several carefully tailored provisions permitting lien-stripping only in certain circumstances. If §506(d) automatically stripped down all liens, not only would those provisions be superfluous, but the limitations they impose on lien-stripping would be eviscerated. Such a reading would make a hash of the Bankruptcy Code's overall design.

In any event, in the twenty years since *Dewsnup* was decided, Congress has acquiesced in its holding. Twice since 1992, Congress has renovated the Bankruptcy Code from top to bottom without touching §506(d) or giving any sign that it disagreed with *Dewsnup*'s holding. Indeed, in 2005 Congress amended §506 itself without doing so. Moreover, Congress has considered and rejected many proposals to expand debtors' ability to strip liens. Finally, during that time,

millions of mortgage loans have been made based on *Dewsnup*'s holding that liens pass through chapter 7 bankruptcy unaffected. Those reliance interests counsel strongly in favor of respecting *stare decisis* here.

ARGUMENT

I. *DEWSNUP* CONTROLS THIS CASE

The Eleventh Circuit's decision cannot be reconciled with this Court's holding and reasoning in *Dewsnup*. *Dewsnup* permits no legal or logical distinction between a partially underwater senior mortgage lien and a wholly underwater junior mortgage lien. Neither can be stripped under §506(d).

A. *Dewsnup* Held That §506(d) Strips Only Liens Securing Disallowed Claims

Dewsnup arose from the debtors' attempt to strip down a partially underwater mortgage lien on their land. The respondent had lent the Dewsnups $119,000, secured by two parcels of Utah farmland. *Dewsnup* v. *Timm*, 502 U.S. 410, 412 (1992). The next year, the Dewsnups defaulted on the loan; before the lender could foreclose, they filed for bankruptcy. *Id.* at 412-413. In their chapter 7 case, the Dewsnups contended that the lien securing the debt should be stripped down to the value of the land—at the time, $39,000. *Id.* at 413. They argued that, under §506(a), the lender's "secured claim" was limited to $39,000; that the remainder of the claim was not an "allowed secured claim" for purposes of §506(d); and that the portion of the lien exceeding $39,000 was therefore void. *Id.* at 413-414.

This Court categorically rejected that reading of the statute. It held that the words "'allowed secured claim' in §506(d) need not be read as an indivisible term

of art defined by reference to §506(a)." *Dewsnup*, 502 U.S. at 415 (describing respondents' position); *id.* at 417 (adopting that position). "Rather, the words should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Id.* at 415; *see id.* at 417. Where a claim "has been 'allowed' ... and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of §506(d)." *Id.* at 415; *see id.* at 417. That construction gives §506(d) "the simple and sensible function of voiding a lien whenever a claim secured by the lien itself has not been allowed" and "ensures that the Code's determination not to allow the underlying claim against the debtor personally is given full effect by preventing its assertion against the debtor's property." *Id.* at 415-416; *see id.* at 417.

The "practical effect" of the debtors' approach, the Court noted, would be "to freeze the creditor's secured interest at the judicially determined valuation," depriving the creditor of "the benefit of any increase in the value of the property by the time of the foreclosure sale" and providing the debtor a potential "windfall." *Dewsnup*, 502 U.S. at 417. That result would be contrary to the basic "bargain[]" of a mortgage: "[T]he creditor's lien stays with the real property until the foreclosure" or payment in full, and any appreciation in the property's value "rightly accrues to the benefit of the creditor" in the event of foreclosure. *Id.*

The Court also explained that the debtors' reading of the statute would represent a radical departure from pre-Code practice, under which "liens pass[ed] through bankruptcy unaffected." *Dewsnup*, 502 U.S. at 417. "Apart from reorganization proceedings," the Court stated, "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Id.* at

418-419. In fact, the Bankruptcy Act of 1898 expressly provided that "[l]iens given or accepted in good faith and not in contemplation of or in fraud upon this Act ... shall not be affected by this Act." Act of July 1, 1898, ch. 541, §67d, 30 Stat. 544, 564.[14]

As *Dewsnup* noted, *see* 502 U.S. at 419, past decisions of this Court also embodied this long-standing principle. As far back as the Bankruptcy Act of 1867, it was clear that "the discharge of [a debtor] in bankruptcy did not release the lien of [a] mortgage." *Long* v. *Bullard*, 117 U.S. 617, 619-621 (1886). Rather, the "right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage" throughout the history of bankruptcy law. *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 580 (1935); *see also Farrey* v. *Sanderfoot*, 500 U.S. 291, 297 (1991) ("Ordinarily, liens and other secured interests survive bankruptcy.").

Indeed, before *Dewsnup* the Court had recognized that liens are property interests with a constitutional dimension: "[O]ur cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral." *United States* v. *Security Indus. Bank*, 459 U.S. 70, 75 (1982) (construing Bankruptcy Code not to modify liens retroactively due to

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[14] Although that specific language was removed by the Chandler Act of 1938, this Court explained that "this was done not to remove the rule of validity [of liens] but because 'the draftsmen of the 1938 Act desired generally to specify only what should be *invalid*.'" *Dewsnup*, 502 U.S. at 418 n.4 (quoting 4B *Collier on Bankruptcy* ¶70.70 (14th ed. 1978)). "The alteration had no substantive effect." *Id.*

constitutional concerns); *see also Radford*, 295 U.S. at 601 (invalidating under the Takings Clause an amendment to the 1898 Act that would have allowed a debtor to redeem mortgaged real property by paying the lender the appraised value of the property—essentially, to strip down the lien to the value of the collateral).

Dewsnup observed that "Congress must have enacted the Code with a full understanding of th[e] practice" that liens passed through liquidation proceedings in bankruptcy unaffected. 502 U.S. at 419. And it noted that the Court had historically been "reluctant to accept [an] argument[] that would interpret the Code ... to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Id.* There being no indication that Congress intended the Code to work such a radical alteration to "basic bankruptcy principles," the Court concluded that it was "not plausible" to read §506(d) to reduce liens to the value of the collateral. *Id.* at 420.

B. This Case Is Indistinguishable From *Dewsnup*

Although *Dewsnup* arose in the context of a partially—rather than wholly—underwater lien, its rationale applies equally to both. The heart of *Dewsnup*'s reasoning was that §506(d) applies only when "a *claim* secured by the lien ... has not been *allowed*"—that is, where the underlying debt is invalid under applicable law. 502 U.S. at 416 (emphasis added); *see id.* at 417. Where a claim "has been 'allowed' ... and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of §506(d)." *Id.* at 415; *see id.* at 417. That is, although §506(a) limits a creditor's secured *claim* for distribution purposes to the current value of its collateral, §506(d) has no such effect on the

creditor's *lien*. Consistent with long-established practice, the lien rides through the bankruptcy and, in the event of default, can be asserted against the collateral if the collateral later increases in value. *Id.* at 417.

As every court of appeals to address the question other than the Eleventh Circuit has concluded, that reasoning also applies to wholly underwater liens. *See Palomar* v. *First Am. Bank*, 722 F.3d 992, 994 (7th Cir. 2013) (Posner, J.) ("*Dewsnup* ... holds that section 506(d) does not allow the bankruptcy court to squeeze down a fully valid lien to the current value of the property to which it's attached. ... That's the relief the debtor in this case is seeking. The only difference between this case and *Dewsnup* is that our debtors want to reduce the value of the lien to zero."); *In re Talbert*, 344 F.3d 555, 560 (6th Cir. 2003) ("The Supreme Court's reasoning for not permitting 'strip downs' in the Chapter 7 context applies with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off.'"); *Ryan* v. *Homecomings Fin. Network*, 253 F.3d 778, 782 (4th Cir. 2001) ("The Court's reasoning in *Dewsnup* is equally relevant and convincing in a case like ours where a debtor attempts to strip off, rather than merely strip down" a wholly underwater lien securing an allowed claim.).

1. As a textual matter, *Dewsnup*'s construction of §506(d) admits of no distinction between partially and wholly underwater liens. *Dewsnup* read the phrase "allowed secured claim" in §506(d) to use the word "secured" in its ordinary, plain-English sense, in which a debt is "secured" if it is "secured by a lien with recourse to the underlying collateral." 502 U.S. at 415; *see id.* at 417. It expressly rejected the debtors' theory, under which the phrase "allowed secured claim" in §506(d) referred only to the portion of such a claim that

is deemed "secured" under §506(a) for purposes of distribution in the bankruptcy case. *See id.* at 414-415, 417.

Here, like the creditor in *Dewsnup*, Bank of America has allowed claims that are "secured by ... lien[s] with recourse to the underlying collateral." 502 U.S. at 415. Bank of America's junior liens give it the right, in the event of default, to foreclose on the debtors' houses. To be sure, because the present value of the collateral is less than the amount outstanding on the senior mortgages, if the houses were sold today, Bank of America would obtain no recovery. But the Bank's liens are nonetheless real and valuable property interests. Outside bankruptcy, if the houses' value had increased so that the junior mortgages were no longer completely underwater, and the debtors had then defaulted, the Bank could have foreclosed and recovered part or all of the debt owed to it. "That is what was bargained for by the mortgagor and the mortgagee," and *Dewsnup* held that bankruptcy does not alter that bargain. *Id.* at 417. Under *Dewsnup*'s logic, the Bank's valid liens are sufficient to render its valid claims "allowed secured claim[s]" for purposes of §506(d).

In their briefs in opposition, respondents contended that the mortgage in *Dewsnup* "qualified as 'an allowed secured claim'" only because its collateral retained some value at the time of bankruptcy. *E.g.*, *Caulkett* Opp. 13. As shown above, that is wrong. For purposes of §506(d), "an allowed secured claim" is an allowed claim "secured by a lien with recourse to the underlying collateral," regardless of the collateral's value. *Dewsnup*, 502 U.S. at 415; *see id.* at 417. *Dewsnup* made clear that the value of the collateral is relevant only to the treatment of the creditor's *claim* under §506(a): To the extent that the creditor's claim exceeds

the value of the collateral, the claim is "unsecured" for distribution purposes. *Id.* at 414-415, 417. The collateral's value has no effect on the treatment of the creditor's *lien* under §506(d)—and that is logically true regardless of whether the lien is first-, second-, or third-priority and regardless of the extent to which it is underwater.

Indeed, a contrary reading would produce an absurd result: If the bankruptcy court valued a house (or any other property) at one dollar more than the amount of a senior lien, the debtor could not strip down a junior lien at all, but if the court valued the property at one dollar less than the amount of the senior lien, the debtor could strip off the entire junior lien. That result would be particularly anomalous in light of the constantly shifting value of real property—and many other kinds of property subject to liens—and the Bankruptcy Code's general aversion to reliance on judicial valuation. *See, e.g., Bank of Am. Nat'l Trust & Sav. Ass'n* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 457 (1999) ("[T]he best way to determine value is exposure to a market. ... [I]t was ... one of the Code's innovations to narrow the occasions for courts to make valuation judgments.").

2. Moreover, *Dewsnup* interpreted §506 not in isolation, but in light of a fundamental bankruptcy principle that has persisted for well over a century: At least in liquidation proceedings like those here, "liens pass through bankruptcy unaffected." 502 U.S. at 417. That principle is as relevant to a wholly underwater junior lien as to a partially underwater senior lien. *See, e.g., Ryan*, 253 F.3d at 783 (the point "'that liens pass through bankruptcy unaffected'" is "'equally pertinent'" to wholly underwater liens). In either case, "the creditor's lien stays with the real property until the foreclo-

sure" because that is the "bargain[]" of secured credit. *Dewsnup*, 502 U.S. at 417; *see also Ryan*, 253 F.3d at 783.

In other words, although the difference in priority affects the lienholders' rights vis-à-vis one another, it does not alter the lienholders' basic rights against the debtor or the debtor's property. While a senior lienholder has first claim on the proceeds of its collateral, a junior lienholder also has rights to the collateral that are superior to those of unsecured creditors or the debtor, and that are not extinguished until foreclosure or payment in full.

Respondents' assertion in their briefs in opposition that there is no equivalent pre-Code practice of junior liens passing through bankruptcy unaffected (*e.g.*, *Caulkett* Opp. 18-19) is thus wrong. As respondents concede (*id.*), junior liens existed before 1978. And the 1898 Act treated them in precisely the same way as senior liens.

Under the 1898 Act, a "secured creditor" was defined simply as a creditor that had "security for [its] debt upon the property of the bankrupt." 1898 Act, §1(23), 30 Stat. at 545. A secured creditor could choose to "stay[] aloof from the bankruptcy proceeding." *Dewsnup*, 502 U.S. at 417. In that event, the creditor would not receive a distribution from the bankruptcy estate, but could still exercise its rights against the debtor's property under its lien following the bankruptcy. *See* 2 *Remington on Bankruptcy* §735 (1956); *see also Long*, 117 U.S. at 620-621. Alternatively, it could file a claim that would permit it to "avail [it]self of [its] security and share in the general assets as to the unsecured balance." *United States Nat'l Bank of Johnstown* v. *Chase Nat'l Bank of N.Y.C.*, 331 U.S. 28, 34

(1947); *see* 1898 Act, §57e, 30 Stat. at 560. That is, an undersecured creditor would have an "unsecured" claim for the amount of the debt in excess of the value of its security interest—just as such a creditor does today. And such a creditor did not lose its lien or have the lien stripped down; rather, valid liens were "not ... affected by th[e] Act." 1898 Act, §67d, 30 Stat. at 564; *Dewsnup*, 502 U.S. at 417-418 & n.4.[15]

As the Act's language makes plain, a lienholder's priority was irrelevant under this statutory scheme. Just like any other undersecured creditor, an underwater junior lienholder could elect to file a claim against the estate for the "unsecured balance" of the debt while retaining its lien. And that makes sense, because the principle underlying the treatment of secured creditors in both the Act and the Code is a principle relating to liens *generally*, and stemming from their recognized status as property rights in the collateral itself.

II. *DEWSNUP*'S STATUTORY HOLDING IS BOTH CORRECT AND SETTLED

This Court need go no further to resolve this case. Should respondent or its amici urge the Court to revisit its analysis in *Dewsnup*, however, it should decline to do so. *Dewsnup* was correctly decided as an original matter, as pre-Code practice and the overarching

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[15] The practice of permitting a secured creditor to participate in distributions from the estate to the extent its claim exceeded the value of its security interest was sometimes called the "bankruptcy rule." *See generally United States Nat'l Bank*, 331 U.S. at 34; Brubaker, *Lien Voiding or Lien Pass-Through Upon Confirmation of a Chapter 11 Plan? (Part I)*, 33 Bankr. L. Letter 12, at 4 (Dec. 2013) (explaining that "th[e] 'bankruptcy rule' has been expressly codified since the Bankruptcy Act of 1867 and is currently reflected in Bankruptcy Code §506(a)(1)").

structure of the Code demonstrate. Moreover, in the two decades since *Dewsnup* was decided, Congress has repeatedly acquiesced in its holding by amending the Code—and §506 in particular—without changing the relevant language of §506(d). Statutory *stare decisis* is thus at its apex here.

A. The Structure Of The Bankruptcy Code Precludes Reading §506(d) To Strip Liens Securing Allowed Claims

Dewsnup observed that, taken in isolation, the language of §506(d) contains "ambiguity." 502 U.S. at 417. The words "secured claim" in the phrase "allowed secured claim" could refer to the portion of a claim that is treated as "secured" for purposes of distribution under §506(a), or they could carry their ordinary English meaning of a claim secured by recourse to collateral. For the reasons given in *Dewsnup* and for the additional reasons below, however, any ambiguity is resolved when §506(d) is read in light of pre-Code practice governing the treatment of secured creditors and the overall architecture of the Bankruptcy Code. As this Court has recognized, interpretation of the Code is "a holistic endeavor," and a phrase that seems "ambiguous in isolation" may become clear if "only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988). That is the case here.

As *Dewsnup* and other decisions of this Court have recognized, and as discussed above, before the enactment of the Bankruptcy Code it was settled law that liens passed through liquidation proceedings unaffected, regardless of the value of the collateral securing them. *Dewsnup*, 502 U.S. at 418; *Radford*, 295 U.S. at

579; *Long*, 117 U.S. at 620-621. And, as this Court has also repeatedly recognized, the Bankruptcy Code should not be read to depart from established pre-Code practice absent a clear indication Congress intended that result. *See, e.g.*, *Dewsnup*, 502 U.S. at 419-420; *Midlantic Nat'l Bank* v. *New Jersey Dep't of Envt'l Prot.*, 474 U.S. 494, 500-501 (1986). That is simply common sense: Although the Code did change pre-Code practice in some respects, by and large it was intended to modernize a somewhat antiquated bankruptcy statute, not to abrogate it. "'[A]bsent a clear indication that Congress intended such a departure,'" the Code should thus not be read "'to erode past bankruptcy practice'"—particularly when that practice is as clear, well-established, and basic to bankruptcy law as it is here. *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998).

Likewise, the Code should not be read to abrogate state-law property rights absent a "'clear and manifest'" contrary intention. *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 543-545 (1994). That presumption stems not only from federalism principles, but also from the nature of bankruptcy itself: Bankruptcy alters state-law rights only when necessary to achieve a bankruptcy objective. *Butner* v. *United States*, 440 U.S. 48, 54, 55 (1979) ("Unless some federal interest requires a different result," "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law," and that principle "appl[ies] with equal force to security interests.").

The Bankruptcy Code shows no such clear intention to strip lienholders of their basic state-law property rights. To the contrary, the overall structure of the Code, together with its drafting and legislative history, demonstrate that the Code is carefully designed to preserve those rights, with certain narrowly cabined ex-

ceptions, principally in reorganization cases. *First*, the context and structure of §506 itself make plain that §506(d) addresses only liens securing *disallowed* claims. *Second*, the Bankruptcy Code contains several other specific provisions that do permit debtors to reduce the value of liens securing valid claims to the current value of the collateral in limited and carefully delineated circumstances. Those provisions would be rendered superfluous if §506(d) were an all-purpose lien-stripping tool.

1. The role that §506 plays in the Bankruptcy Code as a whole, and a review of each of its four subsections—together with the provision's drafting and legislative history—confirm *Dewsnup*'s reading of §506(d).

The provisions of chapter 5 of the Bankruptcy Code apply to all bankruptcy cases, including chapter 7 liquidations, chapter 11 reorganizations, and chapter 13 wage-earner plans (which can be thought of as a type of reorganization for an individual consumer debtor). Subchapter I ("Creditors and Claims"), in which §506 is located, sets out the basic rules governing claims against the estate—their filing, their allowance or disallowance, and their various priorities for distribution purposes.

Unsurprisingly, then, §506 focuses on the treatment of secured *claims*, once those claims have been either allowed or disallowed under §502. As discussed above, it contains four distinct provisions. Section 506(a) splits the allowed claims of undersecured creditors into a secured portion and an unsecured portion. This bifurcation determines the treatment a claim receives: Absent the creditor's consent, "secured claims" under §506(a) must be paid in full, while "unsecured claims" receive only a pro rata share of assets remain-

ing after payment of secured claims. *See* 11 U.S.C. §§1129, 1325. Section 506(b) addresses allowed claims of *over*secured creditors, and §506(c) permits the trustee to recover certain expenses of maintaining collateral securing an allowed claim. Finally, §506(d) addresses what happens if a secured creditor's claim is *disallowed*: In that event, because the underlying debt has been determined to be invalid, the lien securing the debt is voided as well. That ensures that the bankruptcy court's order disallowing the claim cannot be evaded by the creditor's attempting to enforce its lien after the bankruptcy.

The drafting history of §506(d) confirms that interpretation. As originally introduced and enacted, §506(d) provided:

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless (1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 of this title; or (2) such claim was disallowed only under section 502(e) of this title.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §506(d), 92 Stat. 2549, 2583. The original language of §506(d)(1) made clear that a lien was not voided unless a party in interest had objected to the underlying claim and the court had affirmatively disallowed it. *See* 11 U.S.C. §502(a) ("A claim ... is deemed allowed, unless a party in interest ... objects."); *id.* §502(b) ("if such objection to a claim is made, the court ... shall allow such claim" unless, among other exceptions, "such claim is unenforceable ... under any agreement or applicable law"). If no party in interest had objected to the claim, the lien could not be voided. Thus, a lien securing an

allowed claim could not be voided based on the value of the collateral.[16]

Indeed, the Committee Report accompanying the Code stated unambiguously that "[s]ubsection (d) *permits liens to pass through the bankruptcy case unaffected.*" H.R. Rep. No. 95-595, at 357 (1978) (emphasis added). "However[,] if a party in interest requests the court to determine and allow or disallow the claim secured by the lien under section 502 and the claim is not allowed, then the lien is void to the extent that the claim is not allowed." *Id.*; *see also* S. Rep. No. 95-989, at 68 (1978) ("Subsection (d) provides that to the extent a secured claim is not allowed, its lien is void[.]"). Again, it is clear that the value of the collateral has no role to play in this process—all that matters is whether the claim has been disallowed.[17]

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[16] In 1984, Congress amended the exceptions to §506(d), but did nothing to suggest that it was changing the basic purpose of §506(d) to void liens securing *disallowed* claims. Section 506(d)(1) was replaced by §506(d)(2), which creates an exception for any claim that "is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, §448, 98 Stat. 333, 374. The amendment was intended to "make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor." S. Rep. No. 98-65, at 79 (1983). This "[t]echnical and [c]larifying" change, *id.* at 52, ensured that §506(d) voided only liens securing claims affirmatively disallowed because they were substantively invalid, not claims that were not allowed due to a procedural misstep. *See supra* n.4.

[17] That point is reinforced by §522(c) and its legislative history. That section provides, among other things, that a creditor with a debt secured by a lien that is not void under §506(d) (or under the preference and fraudulent transfer provisions of the Code) may enforce its lien after bankruptcy even if the lien is on exempt

2. The overall structure of the Bankruptcy Code also compels this interpretation of §506(d). The Code contains several different provisions that *do* permit debtors to strip down liens to the current value of the collateral. But the Code permits that result only in specific and limited circumstances. Those carefully reticulated provisions cannot be reconciled with a reading of §506(d) that would strip *all* liens down to the value of the collateral. Two provisions of the Code, in different chapters, illustrate the point.

a. Section 722 provides that an individual chapter 7 debtor may "redeem" exempt or abandoned "tangible personal property intended primarily for personal, family, or household use" from a lien securing a dischargeable consumer debt by paying the lienholder the full amount of its allowed secured claim. 11 U.S.C. §722. For example, a chapter 7 debtor might own a car for his personal or family use. Under §522(d)(2) of the Code, the debtor may be able to exempt his interest in the car from the bankruptcy estate. But exempting property from the estate does not invalidate a lien on that property. *See supra* n.17. Section 722 provides an exception to that general rule. If the debtor took out a secured loan to buy the car, and the outstanding amount

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property. 1978 Act, §522(c)(2), 92 Stat. at 2587 (codified at 11 U.S.C. §522(c)(2)). The House and Senate Reports explained that §522(c) codified the rule that the "bankruptcy discharge will not prevent enforcement of valid liens," stating that "[t]he rule of *Long* v. *Bullard*"—under which liens pass through bankruptcy unaffected—"is accepted with respect to the enforcement of valid liens on nonexempt property as well as on exempt property." H.R. Rep. No. 95-595, at 361 (also citing *Radford*, 295 U.S. at 583); *accord* S. Rep. No. 95-989, at 76. Congress thus not only recognized that existing law did not affect the liens of undersecured creditors with allowed claims, but also understood the Code to embody—not abrogate—that rule.

of the loan is now more than the car is worth, under §722 the debtor can pay the lender the car's value—which is the amount of the lender's "secured claim" under §502(a)—and "redeem" the car. The debtor will then own the car free of the lender's lien. *See* 6 *Collier on Bankruptcy* ¶¶722.01-722.05 (16th ed. 2014).

In other words, in those very narrow circumstances, a chapter 7 debtor may strip down the secured creditor's lien to the value of its collateral as determined under §506(a). If §506(d) automatically stripped down liens to the current value of the collateral, debtors could redeem any property encumbered by a lien by paying that value, and §722 would be superfluous. *See, e.g.*, *Hibbs* v. *Winn*, 542 U.S. 88, 101 (2004) ("'A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.'").[18]

Indeed, the incongruity created by the juxtaposition of §722 with a lien-stripping interpretation of §506(d) goes beyond the mere creation of surplusage. Section 722's scope is so narrow and carefully defined

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[18] The dissenters in *Dewsnup* argued that debtors' interpretation of §506(d) created no superfluity because "§506(d) is not a *redemption* provision." 502 U.S. at 428 (Scalia, J., dissenting). "It reduces the value of a lienholder's equitable interest in a debtor's property to the property's liquidation value, but it does not insure the debtor an opportunity to 'redeem' the property at that price." *Id.* But while it is true that §506(d) does not use the word "redeem," its substantive effect, under the *Dewsnup* debtors' interpretation, would nonetheless be to permit the debtor to redeem any property encumbered by a lien securing a dischargeable debt by paying the creditor the current value of the property. If the debtor's personal liability for the debt is discharged, and the creditor's lien is reduced to the property's current value, once the debtor pays the property's current value, the creditor has no further recourse, and the property is effectively "redeemed."

that it disproves any notion that the Code was designed broadly to strip away lienholders' rights under existing law. *Cf. RadLAX Gateway Hotel LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012) (refusing to adopt construction of chapter 11 provision that would override creditor protections in other provisions and noting that "'Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions'"); *United States* v. *Nordic Village Inc.*, 503 U.S. 30, 35 (1992) (adopting construction of §106(c) of the Bankruptcy Code, regarding the scope of waiver of federal sovereign immunity, that "avoids eclipsing the carefully drawn limitations" on waiver set forth in other provisions).

The House and Senate Reports noted that even the modest redemption right given individual debtors under §722 was "a very substantial change" from existing law, S. Rep. No. 95-989, at 95. Ordinarily, a debtor in such a situation would "pay more than the property is worth for the privilege of continuing to use the property.'" H.R. Rep. No. 95-595, at 128. The limited redemption right for exempt or abandoned consumer goods—a type of collateral that, unlike real property, will generally only depreciate in value—was included to ensure that "a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start." *Id.* at 126; *see also id.* at 127-128. The obvious corollary is that the Code does not give the debtor the right effectively to redeem *other* kinds of property, still less all property worth less than the creditor's claim—which would be a far more significant change in the law than the "very substantial change" made by §722.[19]

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[19] Indeed, Congress expressly considered whether to permit a debtor to redeem *any* exempt or abandoned property "from a lien

b. The reorganization chapters of the Code also contain specific provisions governing the treatment of liens that are incompatible with a reading of §506(d) as stripping down all liens to the current value of the collateral.

For instance, except in the case of liens on principal residences, chapter 13 permits a plan to strip down an undersecured creditor's lien to the value of the collateral in certain circumstances. Specifically, a chapter 13 plan may be confirmed over a secured creditor's dissent (or, in bankruptcy jargon, "crammed down") if (1) the creditor will receive under the plan "not less than the allowed amount of [its secured] claim" and (2) the creditor retains its lien until (a) full payment of the underlying debt (not merely the portion that is "secured" under §506(a)) or (b) discharge. 11 U.S.C. §1325(a)(5)(B).

For example, a chapter 13 debtor may own a second home or investment property that is worth less than the outstanding amount of the mortgage on that property—perhaps the property is worth $30,000 but the mortgage is $50,000. Assuming the other requirements of chapter 13 are met, the plan can satisfy the lender's claim by paying it $30,000. But the plan must also provide that the lender retains its lien until either the lender is paid the full $50,000 it is owed, or the debtor successfully completes the plan and obtains a chapter 13 discharge (which, in many cases, does not occur). If the debtor receives a discharge, the lender's lien is effectively stripped down to the $30,000 judicial valuation of the collateral.

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securing a dischargeable debt" and declined to do so. *Compare* H.R. 32, §4-504, 94th Cong. (1974); S. 235, §4-504, 94th Cong. (1974), *with* 1978 Act, §722, 92 Stat. at 2606 (codified at 11 U.S.C. §722).

If §506(d) automatically stripped an undersecured lender's lien down to the value of the collateral, the specific provisions of §1325(a)(5)(B) would, once again, be not only superfluous but entirely incongruous. For one thing, §1325(a)(5)(B)'s requirement that the lender retain its lien until full payment of the debt or discharge would be senseless. Continuing the example above, if the lender's lien is automatically stripped down to $30,000, retention of the lien until the $50,000 debt is paid in full would serve no purpose.

Moreover, as noted above, a chapter 13 plan may not "modify the rights of holders" of "claim[s] secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. §1322(b)(2); *see Nobelman* v. *American Sav. Bank*, 508 U.S. 324, 327-331 (1993). Mortgages on principal residences are thus exempt from chapter 13's cram-down provisions. If §506(d) automatically stripped down all liens, this exception would be pointless.[20]

* * *

In short, as the leading treatise on bankruptcy explains, "it would make no sense to conclude that, while a [debtor] is expressly authorized to adjust the lien rights of a secured creditor under" provisions like §722 and §1325(a)(5), "that authority is ... duplicated in sec-

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[20] Chapter 11's cram-down provisions likewise permit a plan that essentially strips a secured creditor's lien to the value of its collateral, *see* 11 U.S.C. §1129(b)(2)(A)(i), as long as the creditor does not elect to have its entire claim treated as secured, *see id.* §1111(b). As in chapter 13, however, chapter 11's cram-down provisions give the secured creditor certain protections, such as the requirement that the plan be "fair and equitable" overall, *id.* §1129(b)(1), that would be nullified if §506(d) itself could automatically accomplish the same result even in the absence of a plan.

tion 506(d) but without the limitations contained in" the specific provisions governing treatment of liens. 4 *Collier on Bankruptcy* ¶506.06[1][c]. "The better view is that section 506(d) does not authorize lien stripping" because "the ability to adjust the lien rights of secured creditors is provided for elsewhere." *Id.* Indeed, the overall structure and history of the Bankruptcy Code make clear that—consistent with settled pre-Code law—the Code preserves lienholders' state-law rights except where they are expressly limited, and that, subject only to very narrow exceptions, liens pass through chapter 7 unaffected.

B. Congress Has Acquiesced In *Dewsnup*'s Reading Of §506(d)

In the over twenty years since *Dewsnup* was decided, Congress has repeatedly amended the Bankruptcy Code—and §506 itself—without ever suggesting disapproval of *Dewsnup*'s holding. Congress has thus acquiesced in *Dewsnup*'s reading of §506(d).

That acquiescence "'enhance[s] even the usual precedential force'" this Court accords its interpretations of statutes. *Watson* v. *United States*, 552 U.S. 74, 82-83 (2007). As this Court has explained, *stare decisis* applies with "special force in the area of statutory interpretation" because such decisions implicate "the legislative power" and "Congress remains free to alter what [the Court has] done." *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 172-173 (1989); *accord, e.g.*, *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2411 (2014); *Michigan* v. *Bay Mills Indian Cmty.*, 134 S. Ct. 2024, 2036 (2014). Where Congress declines to take such action, the Court's construction of a federal statute effectively becomes a part of the statutory scheme, and subsequent efforts to alter or repeal that

interpretation should be directed to Congress, not to the Court. *See Festo Corp.* v. *Shoketsu Kinzoku Kogyo Kabushiki Co.*, 535 U.S. 722, 739 (2002).

Those principles are particularly compelling in this case. Congress has amended the Bankruptcy Code many times since 1992, including major overhauls in 1994 and 2005, but has never modified §506(d) in response to *Dewsnup*'s interpretation. *See Ankenbrandt* v. *Richards*, 504 U.S. 689, 700-701 (1992) (giving particular weight to congressional inaction following a judicial statutory interpretation "where Congress made substantive changes to the statute in other respects").

The Bankruptcy Reform Act of 1994 made over fifty substantive amendments to the Bankruptcy Code, but took no action to overturn or modify *Dewsnup*. Pub. L. No. 103-394, 108 Stat. 4106. That was not because of any reluctance to overturn this Court's interpretations of the Code, including interpretations favorable to secured creditors: The same bill "overrul[ed]" this Court's decision in *Rake* v. *Wade*, 508 U.S. 464 (1993), which had held that oversecured creditors were entitled to interest on home-mortgage arrearages under a chapter 13 plan notwithstanding the terms of the underlying agreement. H.R. Rep. No. 103-835, at 55 (1994); 1994 Act, §305, 108 Stat. at 4134. Indeed, the House Report identified dozens of judicial decisions that the 1994 Act was intended to modify or overrule. *See, e.g.*, H.R. Rep. No. 103-835, at 42, 45, 47, 48, 52, 57, 58. Had Congress felt any similar dissatisfaction with the Court's holding in *Dewsnup*, the 1994 Act would have been an obvious opportunity to correct it.

Similarly, in 2005 Congress enacted a major set of reforms to the Bankruptcy Code, including over 150 substantive amendments. *See* Bankruptcy Abuse Pre-

vention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23. Notably, BAPCPA amended §506 itself without taking any action to supersede or modify *Dewsnup*'s holding. Specifically, Congress amended §506(a) to provide that, in an individual chapter 7 or 13 case, personal property subject to a lien must be valued by reference to "the replacement value of such property." BAPCPA, §327, 119 Stat. at 99-100.[21] BAPCPA also added an exemption from §506 in chapter 13 for consumer debts secured by purchase-money security interests incurred within a certain period prior to bankruptcy, effectively allowing such creditors' entire claims to be treated as secured. BAPCPA, §306(b), 119 Stat. at 80 (codified at 11 U.S.C. §1325(a) (hanging paragraph)). Congress thus had the opportunity to—and did—consider and amend §506, while doing nothing to change *Dewsnup*'s interpretation of §506(d). Particularly in a context in which Congress has proven willing and able to alter judicial interpretations of the Code of which it disapproves,[22] Congress's failure to take such action here

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[21] The amendment responded to this Court's holding in *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953 (1997)—which held that in a chapter 13 case, collateral retained by the debtor must be valued at the debtor's cost to replace it, not its liquidation value—and clarified that *Rash*'s holding also applied to chapter 7.

[22] *See, e.g.*, Christiansen & Eskridge, *Congressional Overrides of Supreme Court Statutory Interpretation Decisions, 1967-2011*, 92 Tex. L. Rev. 1317, 1385 & nn.245-247 (2014) (documenting 8 "overrides" of this Court's bankruptcy decisions since 1984); Bussel, *Textualism's Failures: A Study of Overruled Bankruptcy Decisions*, 53 Vand. L. Rev. 885, 904, 918 tbl. 2 (2000) (identifying 58 "statutory overrulings" of bankruptcy-related judicial precedents between 1979 and 1998); Eskridge, *Overriding Supreme Court Statutory Interpretation Decisions*, 101 Yale L. J. 331, 344

demonstrates affirmative acquiescence in *Dewsnup*'s holding.

Two related facts reinforce this conclusion. *First*, since this Court's decision in *Dewsnup*—and particularly since 2005, when Congress last significantly reformed the Code—Congress has not only failed to call *Dewsnup* into question, it has also rejected reforms to the Code that would have limited *Dewsnup*'s effect. Numerous hearings have been held on secured creditors' rights in bankruptcy, particularly with respect to permitting debtors to strip down underwater mortgages on principal residences to the present value of the collateral.[23] And since 2005, more than a dozen bills have been introduced that would have done precisely that.[24] While some of those bills were referred out of

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tbl. 4 (1991) (identifying 10 "overrid[es]" of this Court's bankruptcy decisions between 1967 and 1990).

[23] *See, e.g., The Looming Foreclosure Crisis: How To Help Families Save Their Homes, Hearing Before the S. Comm. on the Judiciary*, 110th Cong. (2007); *Straightening Out The Mortgage Mess: How Can We Protect Home Ownership And Provide Relief To Consumers In Financial Distress? (Part II), Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (2007); *Growing Mortgage Foreclosure Crisis: Identifying Solutions And Dispelling Myths, Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (2008); *Helping Families Save Their Homes In Bankruptcy Act Of 2009, And The Emergency Homeownership And Equity Protection Act, Hearing Before the H. Comm. on the Judiciary*, 111th Cong. (2009).

[24] *See, e.g.*, S. 2136, 110th Cong. (2007); H.R. 3609, 110th Cong. (2007); S. 2133, 110th Cong. (2007); H.R. 3778, 110th Cong. (2007) (related to S. 2133); S. 2636, 110th Cong. (2008); H.R. 200, 111th Cong. (2009); H.R. 225, 111th Cong. (2009); S. 61, 111th Cong. (2009); S. 895, 111th Cong. (2009); H.R. 1106, 111th Cong. (2009); H.R. 1587, 112th Cong. (2011); H.R. 4058, 112th Cong. (2012); H.R. 101, 113th Cong. (2013).

Committee and a few made it to a full vote, none has been enacted. Moreover, the legislation Congress rejected would have provided far more protection to secured creditors than overriding this Court's interpretation of §506(d) would have done. For instance, all such bills would have limited lien-stripping to chapter 13, which requires debtors to prepare a repayment plan under judicial supervision and to allocate all disposable income to payments under the plan. *See* 11 U.S.C. §1322(a)(1), (b)(5); *id.* §1325(a)(5), (b)(1). "Congress's failure to act on the bills proposed on this subject"—and its "abundant[] aware[ness]" of *Dewsnup*—"provides added support for concluding that Congress acquiesced." *Bob Jones Univ.* v. *United States*, 461 U.S. 574, 600, 601 (1983).

Second, "*[s]tare decisis* has added force when ... citizens, in the private realm, have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations." *Hilton* v. *South Carolina Pub. Rys Comm'n*, 502 U.S. 197, 202 (1991). That is the case here.

Lending markets necessarily factor risk, including risks associated with a mortgagor's bankruptcy, into lending decisions and pricing. The essence of secured credit is that the creditor is able to look to his collateral—and to demand it or the full payment of the debt. For decades, secured credit has been extended and priced based on *Dewsnup*'s holding that liens, including underwater liens, ride through chapter 7 bankruptcy unaffected. It would be an enormous and unwarranted disruption of settled expectations for the Court to reverse course now. "As in other cases involving contract and property rights, concerns of *stare decisis* are ... 'at their acme'" in a case like this one. *Bay Mills*, 134 S. Ct. at 2036; *see also Payne* v. *Tennessee*, 501 U.S. 808,

828 (1991) (collecting cases). The settled expectations that have formed among secured creditors because of this Court's holding and Congress' acquiescence in it counsel strongly in favor of respecting settled precedent.

CONCLUSION

The judgments of the court of appeals should be reversed.

Respectfully submitted.

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STATUTORY ADDENDUM

11 U.S.C. §502. Allowance of claims or interests

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

> (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;
>
> * * *

11 U.S.C. §506. Determination of secured status

> (a) (1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposi-

tion or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. §722. Redemption

An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien in full at the time of redemption.

11 U.S.C. §1322. Contents of plan

(a) The plan—

(1) shall provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) shall provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim;

(3) if the plan classifies claims, shall provide the same treatment for each claim within a particular class; and

(4) notwithstanding any other provision of this section, may provide for less than full payment of all amounts owed for a claim entitled to priority under section 507(a)(1)(B) only if the plan provides that all of the debtor's projected disposable income for a 5-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(b) Subject to subsections (a) and (c) of this section, the plan may—

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within

a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity;

(10) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims; and

(11) include any other appropriate provision not inconsistent with this title.

* * *

11 U.S.C. §1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that—

(I) the holder of such claim retain the lien securing such claim until the earlier of—

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if—

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required

by a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day period preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

* * *

BANKRUPTCY REFORM ACT OF 1978, PUB. L. NO. 95-598, 92 STAT. 2549 (excerpts)

* * *

§506. Determination of secured status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided under the agreement under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—

(1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 of this title; or

(2) such claim was disallowed only under section 502 (e) of this title.

* * *

§722. Redemption

An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

* * *

ACT OF JULY 1, 1898, CH. 541, 30 STAT. 544 (excerpts)

* * *

§57. Proof and Allowance of Claims

(a) Proof of claims shall consist of a statement under oath, in writing, signed by a creditor setting forth the claim, the consideration therefor, and whether any, and, if so what, securities are held therefor, and whether any, and, if so what, payments have been made thereon, and that the sum claimed is justly owing from the bankrupt to the creditor.

* * *

(d) Claims which have been duly proved shall be allowed, upon receipt by or upon presentation to the

court, unless objection to their allowance shall be made by parties in interest, or their consideration be continued for cause by the court upon its own motion.

(e) Claims of secured creditors and those who have priority may be allowed to enable such creditors to participate in the proceedings at creditors' meetings held prior to the determination of the value of their securities or priorities, but shall be allowed for such sums only as to the courts seem to be owing over and above the value of their securities or priorities.

* * *

(h) The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance.

* * *

§67. Liens

* * *

(d) Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act.

* * *

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In the Supreme Court of the United States

BANK OF AMERICA, N.A., PETITIONER

v.

DAVID B. CAULKETT, RESPONDENT

BANK OF AMERICA, N.A., PETITIONER

v.

EDELMIRO TOLEDO-CARDONA, RESPONDENT

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR RESPONDENTS

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QUESTION PRESENTED

In *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), this Court held that a claim in a chapter 7 bankruptcy proceeding is an "allowed secured claim" under 11 U.S.C. § 506(d)—and a lien securing the claim therefore is valid—even if the claim is only partially secured under 11 U.S.C. § 506(a). The question presented is whether a claim is an "allowed secured claim" under Section 506(d) if it is completely *un*secured under Section 506(a).

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ADDITIONAL STATUTORY PROVISION INVOLVED

In addition to the statutes reprinted by petitioner, Br. 2–3, 1a–11a, another pertinent statutory provision, 11 U.S.C. § 1111, is reprinted in the appendix to this brief. App., *infra*, pp. 1a–2a.

STATEMENT

The second mortgages at issue in this case are "completely underwater": each home is worth less than the balance owed on its *first* mortgage, so there is no value left over to secure its second mortgage. Thus, each of petitioner's claims based on these second mortgages is not a secured claim, because under 11 U.S.C. § 506(a), it is secured only to the extent of "the value of [petitioner's] interest" in each property, which is zero. And because it is not a secured claim, the lien associated with that claim is void: under 11 U.S.C. § 506(d), "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."

This reading gives full effect to the word "secured" in Section 506(d), which petitioner renders pure surplusage. It also fits with the longstanding pre-Code practice of voiding completely underwater junior liens in bankruptcy. Liens that are supported by value are preserved. But completely underwater liens, which would be extinguished in foreclosure, do not give second mortgagees leverage to hold up loan modifications between debtors and first mortgagees.

Dewsnup v. *Timm*, 502 U.S. 410 (1992), did not alter this straightforward application of the text. *Dewsnup* did not address a situation like this one, in which the mortgage is *completely* underwater, and

the Court's opinion emphasized that its narrow holding did not reach this situation. There is no basis for extending *Dewsnup* to override the express language of Section 506 and cover this case.

1a. *Bankruptcy law.* Since at least the nineteenth century, bankruptcy law has served the "two-fold purpose" of "convert[ing] the estate of the bankrupt into cash and distribut[ing] it among creditors, and then . . . giv[ing] the bankrupt a fresh start." *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913). To distribute the debtor's estate equitably, a chapter 7 liquidation first ensures that secured claims are satisfied or sufficiently protected, and then distributes the estate's assets pro rata among the general unsecured claims. *See* 11 U.S.C. §§ 506, 725, 726(b).

In order to distribute the estate, the bankruptcy court receives the claims of creditors, rules on any objections, and determines the extent to which each claim may participate in the distribution. An "allowed claim" is a claim eligible to participate in the distribution of estate assets. *See, e.g.*, 11 U.S.C. §§ 502, 724(b), 726(a)(2). Within the set of "allowed claim[s]," Section 506(a) specifies which qualify as "secured claim[s]" or "unsecured claim[s]":

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a)(1). Section 506 applies equally to liquidations, reorganizations, and adjustments of debts, regardless of whether they are filed under chapter 7, 11, 12, or 13. 11 U.S.C. § 103(a).

In bankruptcy, an allowed claim can be completely secured, completely unsecured, or "bifurcat[ed]" into "secured claim and unsecured claim components." *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 239 n.3 (1989) (internal quotation marks omitted). Under Section 506(a), the degree of security depends on the value of the creditor's interest in the property. If the value of the creditor's interest is greater than or equal to the claim, it is completely secured under Section 506(a). If the value of the creditor's interest is zero (i.e., the mortgage is completely underwater, as commonly occurs with second mortgages), the claim is completely unsecured. If the value is between zero and the amount of the claim (i.e., the mortgage is "partially underwater"), it is bifurcated into a secured component (equal to the value of the creditor's interest in the property) and an unsecured component (equal to the remaining amount of the claim).

Thus, outside of bankruptcy, a $150,000 first mortgage and a $25,000 second mortgage on a $200,000 home are both "secured" loans because there are state-law-created liens on the home securing the loans. But in bankruptcy, the secured status of a claim is governed by federal bankruptcy law and determined by the *value* underlying the claim, not the mere existence of a lien. For example, if the property's value drops from $200,000 to $100,000, the first mortgage is undersecured, or partially un-

derwater. In that situation, because the first mortgage is senior to the second, the value of the collateral is applied to the first mortgage before the second. Section 506(a) bifurcates the first mortgage claim into a $100,000 secured claim and a $50,000 unsecured claim. Because the second mortgage is completely underwater (as there is no remaining value in the property to secure the debt), Section 506(a) leaves the second mortgagee with a $25,000 *un*secured claim. 11 U.S.C. § 506(a)(1).

After a bankruptcy court values the property and designates allowed secured and unsecured claims under Section 506(a), it must determine if any liens associated with those claims are void under Section 506(d). That subsection provides: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void" (unless the claim was disallowed solely because it was unmatured or contingent or because the creditor failed to file a proof of claim). 11 U.S.C. § 506(d). If a lien is void, the creditor can still receive distributions from the estate along with other unsecured creditors. At the end of the bankruptcy case, the debtor becomes eligible for a discharge and the estate is distributed.

b. *Dewsnup* v. *Timm*. In *Dewsnup*, the value of the debtor's farmland had fallen below the value of her first and only mortgage. 502 U.S. at 413. In other words, the mortgage was *partially* underwater. The debtor contended that the amount of the lien associated with the mortgage should be reduced to the value of the property under Section 506(d). *Id.* The Court read the phrase "allowed secured claim" in

Section 506(d) to include the partially secured claim in that case, and therefore held that Section 506(d) did not reduce the amount of the lien. *Id.* at 417. Emphasizing the "difficulty" posed by various "[h]ypothetical applications," including that of a completely underwater mortgage, the Court "focus[ed] upon the case before [it] and allow[ed] other facts to await their legal resolution on another day." *Id.* at 416–17; *see* 90–741 Oral Arg. Tr. 8–9.

2. *Facts and procedural history.* Respondent David Caulkett bought his home in June 2006 for $249,500. Two divisions of Countrywide Financial financed the entire purchase with a $199,600 first mortgage and a $49,900 second mortgage. Opp. 5. At the time of the purchase, the first mortgage had a loan-to-value ratio of 80% and the two mortgages had a combined loan-to-value ratio of 100%. Soon after he bought his home, the housing market crashed and his home's value plummeted. Seterus, a loan-servicing company, later acquired some rights to the first mortgage. Opp. 5–6.

Respondent Edelmiro Toledo-Cardona bought his home in 2001 for $80,000, taking out an $82,872 mortgage to cover the purchase price and closing costs. Opp. 5. His initial loan-to-value ratio was 103.6%. In 2012, Quicken Loans refinanced his first mortgage with a new $135,900 loan. *Id.* At the time of this refinancing, the property was also encumbered by a $32,000 second mortgage that had been originated by Countrywide Bank in 2007. *Id.* By agreement, Countrywide resubordinated its lien to the new Quicken Loans mortgage. Opp. 5–6.

Petitioner purchased Countrywide in early 2008, acquiring rights to Messrs. Caulkett's and Toledo-Cardona's second mortgages. *Id.*; Caulkett Opp. 5.

In 2013, Messrs. Caulkett and Toledo-Cardona filed chapter 7 bankruptcy petitions in the U.S. Bankruptcy Court for the Middle District of Florida. Caulkett Opp. 6; Toledo-Cardona Opp. 6. As of his filing, Mr. Caulkett's home was valued at $98,000. The outstanding balances on his first and second mortgages were $183,264 and $47,855, respectively, totaling $231,119. Opp. 6. The balance owed on his first mortgage alone was almost twice the value of the home (187%), and the two mortgages had a combined loan-to-value ratio of 235.8%.

As of his filing, Mr. Toledo-Cardona's home was valued at $77,689. The outstanding balances on his mortgages were $135,703 and $32,000, respectively, totaling $167,703. Opp. 6. The balance owed on his first mortgage was also almost twice the value of the home (174.7%), and the two mortgages had a combined loan-to-value ratio of 215.9%. Petitioner did not contest either home's valuation.

Invoking 11 U.S.C. § 506(a) and (d), respondents moved to void each of petitioner's second mortgage liens because each was completely underwater. Caulkett Pet. App. 5a; Toledo-Cardona Pet. App. 7a. Petitioner conceded that each lien was void under Eleventh Circuit precedent. Each bankruptcy court accordingly voided the respective lien. Caulkett Pet. App. 6a; Toledo-Cardona Pet. App. 8a. On appeal, petitioner moved for summary affirmance of each judgment against it, and each district court summar-

ily affirmed. Caulkett Pet. App. 3a; Toledo-Cardona Pet. App. 5a.

The Eleventh Circuit affirmed in both cases. Caulkett Pet. App. 2a; Toledo-Cardona Pet. App. 3a. The court reasoned that although *Dewsnup* held that courts cannot void partially underwater liens, it did not overturn circuit precedent authorizing courts to void completely underwater liens. Caulkett Pet. App. 2a; Toledo-Cardona Pet. App. 2a–3a.

SUMMARY OF ARGUMENT

I. The text of the Bankruptcy Code is clear. Section 506(a) classifies every allowed claim with a lien as a "secured claim" or an "unsecured claim" depending on whether the collateral's value suffices to satisfy the claim. As petitioner concedes, if a second mortgage is completely underwater, the creditor "ha[s] only an 'unsecured claim'" under Section 506(a). Br. 11.

Section 506(d) then determines the validity of the claims' corresponding liens. It provides, with two exceptions not relevant here, that unless a claim is "an allowed secured claim, such lien is void." When a mortgage is completely underwater, no component of the mortgage is secured in bankruptcy. Thus, there is no "allowed secured claim" and the associated "lien is void."

Claims and liens are created by nonbankruptcy law, but the phrase "secured claim" is bankruptcy law's evaluation of them. Thus, Section 506 and other Code provisions use the phrase "lien secur[ing] a claim" to refer to nonbankruptcy rights, and "allowed secured [or unsecured] claim" to designate how bank-

ruptcy law treats those rights. Petitioner's reading equates the two phrases in Section 506(d) (but not elsewhere in the Code), which makes "secured claim" redundant, renders the word "secured" surplusage, and severs Section 506(d) from Section 506(a)'s definition. Petitioner's reading would also override other limitations specified elsewhere in the Code.

II. *Dewsnup* is not to the contrary. Because it contravened the natural reading of the text, as the Court acknowledged, *Dewsnup*'s holding was explicitly narrow. That case involved a partially underwater mortgage and hence a partially secured claim. In that context, the Court viewed the statute as minimally ambiguous as to whether such a partially secured claim qualified as an "allowed secured claim."

In order to expand *Dewsnup*'s holding to reach this case, petitioner repeatedly quotes or cites the Court's description of the *creditors'* position in *Dewsnup* as if it were the Court's holding. But *Dewsnup* did not—and had no occasion to—resolve whether a completely "unsecured claim" under Section 506(a) could still be an "allowed secured claim" under Section 506(d). Indeed, the situation presented here by a completely underwater second mortgage was a "[h]ypothetical . . advanced at oral argument" that the Court's opinion expressly declined to reach and reserved for "resolution on another day." 502 U.S. at 416–17; *see* 90–741 Oral Arg. Tr. 8–9.

When the Court returned to the issue of partially secured mortgages a year after *Dewsnup*, it clearly distinguished between partially and completely underwater mortgages, relying on the presence of some

value to establish a "secured claim." *Nobelman* v. *Am. Sav. Bank*, 508 U.S. 324, 329 (1993). That line between mortgages with and without value is consistent with this Court's longstanding pre-Code practice of voiding completely underwater second mortgage liens because "[t]here [i]s no value to be protected." *In re 620 Church St. Bldg. Corp.*, 299 U.S. 24, 27 (1936). In the context of a partially secured claim, *Dewsnup* stated that Congress had not clearly overridden perceived pre-Code practice allowing liens to pass through bankruptcy. 502 U.S. at 417–20. But that contested practice was not an absolute rule, and neither the parties nor the Court in *Dewsnup* had occasion to consider *620 Church Street*. Pre-Code law authorized voiding completely underwater mortgage liens, so the historical practice cited by *Dewsnup* is absent here.

The policy considerations that motivated *Dewsnup* apply very differently to completely underwater second mortgages. Real property rarely if ever becomes completely valueless, so in practice only junior mortgages can be completely unsecured. *Dewsnup* sought to stop a debtor from using bankruptcy to give the creditor a worse deal than it might have gotten in foreclosure; here, conversely, a junior creditor who would receive nothing in foreclosure seeks more favorable results in bankruptcy. Because completely underwater second mortgages are valueless in foreclosure, second mortgagees have nothing to lose by using them as leverage to hold up deals between first mortgagees and debtors, in the hope of extracting payments.

Voiding completely underwater second mortgage liens, however, benefits first mortgagees, who can

more easily work out loan modifications so that debtors keep making payments. That flexibility helps unclog the housing market and prevents foreclosures, abandoned homes, and neighborhood blight.

Moreover, voiding a second mortgage lien does not violate the parties' original bargain. Second mortgagees bargained for their subordinate position and should expect that if their mortgages sink completely underwater, their worthless liens can be extinguished in foreclosure.

III. Petitioner's remaining arguments are meritless. We do not and have never argued that this Court need overrule *Dewsnup*, so all of petitioner's *stare decisis*, reliance, and legislative-ratification arguments are beside the point. *Dewsnup* did not reach or resolve the question presented here, and one cannot rely on what this Court has not done. Similarly, petitioner misses the mark by arguing that overruling *Dewsnup* might render certain provisions surplusage: because *Dewsnup* is the law, debtors must turn to those other provisions to address partially secured claims.

Nor is there any problem with judicial valuation or with line-drawing based on the dollar value of property. The Bankruptcy Code routinely relies on judicial assessments of present value, draws lines on that basis, and contains ample safeguards for creditors. The snippets of legislative history cited by petitioner are makeweights that do not resolve the question here. Finally, this Court has repeatedly rejected petitioner's constitutional objection to voiding valueless liens.

ARGUMENT

I. SECTION 506 OF THE BANKRUPTCY CODE EXPRESSLY VOIDS LIENS THAT ARE UNSUPPORTED BY ANY VALUE

The question presented here is how to construe 11 U.S.C. § 506. Although petitioner and its amici avoid focusing on the statute's text, the interpretation of a statute must "begin with the understanding that Congress 'says in a statute what it means and means in a statute what it says there.'" *Hartford Underwriters Ins. Co.* v. *Union Planters Bank, NA*, 530 U.S. 1, 6 (2000) (quoting *Conn. Nat'l Bank* v. *Germain*, 503 U.S. 249, 254 (1992)). That is particularly true in bankruptcy law. "The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is [the Court's] obligation to interpret the Code clearly and predictably using well established principles of statutory construction." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012).

These principles resolve this case. The Code clearly and unambiguously voids completely underwater mortgage liens. There is no need to rummage through pre-Code practice, legislative history, or policy arguments, which are in any event consistent with the text. Section 506(a)(1) provides that a completely underwater claim "is an unsecured claim." Section 506(d) provides that the claim's associated "lien is void." Any other reading does violence to the text of Section 506 as well as to express limitations elsewhere in the Code.

A. Section 506 Expressly Provides that a Completely Underwater Claim "Is an Unsecured Claim," Not an "Allowed Secured Claim," so a Completely Underwater "Lien Is Void"

1. *Section 506(d) expressly voids liens when their underlying claims are either disallowed or unsecured under Section 506(a).* Section 506(d) provides that, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." Thus, a lien is void if its associated "claim . . . is not an allowed secured claim." According to ordinary rules of grammar, a claim must be both "allowed" and "secured" in order to be an "allowed secured claim." A claim that is not "allowed" or not "secured" is not an "allowed secured claim." Under Section 506(d), its associated "lien is void."

The parties to this case have no dispute about the "allowed" part of that analysis. A claim may be disallowed under 11 U.S.C. § 502, often because it is unenforceable or excessive in relation to the claimant's contractual rights or the estate's interest in the property. Everyone agrees that when a claim is not "allowed," its associated "lien is void" under Section 506(d). Under the terms of Section 506(d), the same is true if a claim is not "secured."

To determine whether a claim is "secured," the obvious source is a preceding subsection of Section 506, 11 U.S.C. § 506(a). That provision expressly defines the extent to which a claim is "secured" for purposes of bankruptcy law. It provides: "An allowed claim of a creditor secured by a lien on proper-

ty . . . is a *secured claim* to the extent of the value of such creditor's interest in . . . such property . . . ." *Id.* (emphasis added). Thus, if the value of the creditor's interest in the property is equal to or greater than the creditor's claim, an allowed claim is also a secured claim. Section 506(a) also expressly addresses the situation in which the value of the creditor's interest is less than its claim. In that case, "[a]n allowed claim . . . is an *unsecured claim* to the extent that the value of such creditor's interest . . . [in the property] is less than the amount of such allowed claim." *Id.* (emphasis added). Thus, if the value of the creditor's interest in the property is zero (as petitioner agrees is true here, Br. 26), then Section 506(a) expressly provides that the creditor's claim "is an unsecured claim."

If a claim is "unsecured," and so not an "allowed secured claim," like petitioner's claims here, Section 506(d) is explicit about what happens to the "lien secur[ing] [that] claim": "such lien is void." That is what the court of appeals correctly held. Indeed, because that conclusion is based directly on the terms of the governing statute, it would take an "exceptional[]" showing to refute it. *Union Bank* v. *Wolas*, 502 U.S. 151, 155–56 (1991). The statute is clear, and "that is the end of the matter." *Chevron U.S.A., Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842 (1984).

Dewsnup is not to the contrary. There, the sole mortgage was *partially* underwater because the mortgaged property retained some value, albeit less than the outstanding debt. In that situation, the mortgage comprises both "secured claim and unsecured claim components." *Ron Pair*, 489 U.S. at 239

n.3 (internal quotation marks omitted). *Dewsnup* held that such a partially secured claim remains an "allowed secured claim" and so prevents Section 506(d) from voiding the associated lien.

But where, as here, a mortgage is *completely* underwater, no component of the mortgage is secured in bankruptcy. A completely "unsecured claim" under Section 506(a) cannot be "an allowed secured claim" under Section 506(d). There is no sound basis for extending *Dewsnup* to the completely *un*secured claim here. *Infra* pp. 26–28.

2. *"Lien secures a claim" and "secured claim" in Section 506(d) are independent phrases with distinct meanings.* Section 506(d) uses two phrases—"lien secures a claim" and "secured claim"—that sound similar but are distinct. Petitioner treats these two phrases as redundant. *See infra* pp. 17–18. But the two terms have different meanings throughout the Bankruptcy Code. The phrase "lien secures a claim" describes nonbankruptcy-law rights, while "secured claim" is a "term of art" defined by bankruptcy law. *Nobelman*, 508 U.S. at 331.

a. A mortgage comprises two state-law elements: (1) a debt backed by (2) a lien. *See* BLACK'S LAW DICTIONARY 1101 (9th ed. 2009). The debt gives rise to a "claim" under bankruptcy law because it establishes a "right to payment." 11 U.S.C. § 101(5)(A). As petitioner acknowledges, both the claim and the associated mortgage lien are creatures of state law. Br. 5, 31. Thus, Section 506(d) recognizes that "a lien secures a claim" as a matter of nonbankruptcy law, just as a "lien securing such claim" is "recognized by applicable

nonbankruptcy law" in chapter 13. 11 U.S.C. § 1325(a)(5)(B)(i)(I), (II); *see also id.* § 552(b)(1); *cf. Patterson* v. *Shumate*, 504 U.S. 753, 757–59 (1992) (discussing "applicable nonbankruptcy law").

b. While the phrase "lien secures a claim" refers to nonbankruptcy law, the term "secured claim" refers to federal bankruptcy law. Indeed, the heading of Section 506—"Determination of secured status"—makes that clear. Statutory titles and headings, while not conclusive, are useful tools for interpreting statutes. *Fla. Dep't of Rev.* v. *Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 47 (2008); *Porter* v. *Nussle*, 534 U.S. 516, 527–28 (2002). In "[d]etermin[ing] secured status," Section 506 naturally addresses liens (which are fundamental to secured status) as well as claims. Section 506(d) accordingly concludes that if a claim is either disallowed or unsecured, its associated "lien is void." That statutory text refutes petitioner's unsupported and counter-textual assertion that Section 506 is somehow "primarily directed to the treatment of secured *claims*, not to the treatment of *liens*." Br. 20; *accord id.* at 32.

Accordingly, Section 506(a)(1) provides that an "allowed claim" is either a "secured claim" or an "unsecured claim" based on its bankruptcy valuation. That bankruptcy classification is given effect three subsections later, in Section 506(d). How the nonbankruptcy "lien secur[ing] a claim" is treated under Subsection (d) depends on whether the claim is or "is not an allowed secured claim" in bankruptcy. This simple, straightforward reading gives effect to each word in the term "allowed secured claim" and Section 506(d) as a whole.

c. Moreover, although *Dewsnup* treated even a partially secured claim under Section 506(a) as "secured" under Section 506(d), that leaves the statutory phrase "[t]o the extent that" to do significant work in the statute. To be sure, "[t]o the extent that" has no effect on partially secured claims and their associated liens. But "[t]o the extent that" remains necessary to address "allowed" claims. Many claims are only partially allowed, such as claims that exceed "the reasonable value" of an attorney's services under 11 U.S.C. § 502(b)(4). Although *Dewsnup* accorded "secured" status under Section 506(d) to fully or partially secured claims, liens associated with partially allowed claims are void only to the extent that they are not allowed.

B. Petitioner's Contrary Argument Contradicts the Express Terms of the Statute, Creates Surplusage, and Is Inconsistent with the Rest of the Code

1.a. *Petitioner cannot provide an intelligible reading of Section 506.* Quoting the position of the creditors in *Dewsnup* rather than the Court's holding, petitioner argues that the term "secured claim" requires only that the claim be "'secured by a lien with recourse to the underlying collateral,' regardless of the collateral's value." Br. 26. That assertion directly contradicts the terms of Section 506(a). That subsection states that a creditor's claim "is a secured claim to the extent of the value of [the] creditor's interest in . . . such property" and "is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." Contrary to petitioner's assertion, se-

cured status expressly requires a determination of "the value of [the] creditor's interest in . . . such property." *Id.* Thus, the mere fact that a lien has "recourse to the underlying collateral, regardless of the collateral's value," Pet. Br. 26, is *not* sufficient to give it "secured" status in bankruptcy.

b. *Petitioner's reading renders the word "secured" surplusage.* Section 506(d) provides that, "[t]o the extent that a lien secures a claim . . . that is not an allowed secured claim, such lien is void." That sentence begins by identifying a "lien" that secures a "claim" and then provides for the circumstances in which that "lien is void," i.e., when the claim "is not an allowed secured claim." Under petitioner's reading, however, *every* "lien [that] secures a claim" will be a "secured claim." Therefore, the word "secured" does no work at all. As petitioner puts it, Section 506(d) "strips only liens securing *disallowed* claims." Br. 19. If petitioner were right, the word "secured" in the phrase "allowed secured claim" could (and therefore should) have been omitted.

If extended throughout the Code, petitioner's reading would likewise render surplusage other provisions that juxtapose "property securing" or "lien[s] secur[ing] claim[s]" with "allowed secured claim[s]." *E.g.*, 11 U.S.C. §§ 506(a)(1), 506(b), 506(c), 722, 724(e)(2). In a few places in the Code, the phrases *must* mean different things, or else a claim could be simultaneously secured and unsecured. For instance, a trustee can "avoid a lien that secures a claim" that is "any allowed claim, *whether secured or unsecured*, for" noncompensatory fines or punitive damages. 11 U.S.C. §§ 724(a), 726(a)(4) (emphasis

added). Likewise, Section 506(a)(1) provides (emphases added): "An allowed *claim* of a creditor *secured by a lien* on property . . . *is an unsecured claim* to the extent that the value . . . is less than the allowed amount of such claim." Unless these provisions are contradictory or nonsensical, they must refer separately to nonbankruptcy and bankruptcy law.

"It is [the Court's] duty to give effect, if possible, to every clause and word of" the Bankruptcy Code. *Hoffman* v. *Conn. Dep't of Income Maint.*, 492 U.S. 96, 103 (1989) (internal quotation marks omitted); *accord Rake* v. *Wade*, 508 U.S. 464, 471 (1993). Petitioner's argument equating the two phrases must therefore be rejected.

c. *Section 722.* Even petitioner cannot consistently maintain that the two phrases ("lien secures a claim" and "secured claim") mean the same thing throughout the Code. Petitioner acknowledges that they mean different things—and that our reading is correct—when discussing Section 722 of the Code. Br. 36.

Section 722 gives debtors the right to "redeem tangible personal property . . . from a *lien securing a dischargeable consumer debt* . . . by paying the holder of such lien the amount of the *allowed secured claim* of such holder that is secured by such lien in full at the time of redemption" (emphases added). Using the example of a car, petitioner acknowledges that "the amount of the lender's 'secured claim'" is limited to "the car's value," *not* (as its reading of Section 506(d) would have it) the entire amount of the "lien securing [the] dischargeable consumer debt." Pet. Br. 36; 11 U.S.C. § 722.

In other words, the "lien securing a dischargeable consumer debt" in Section 722 is a creature of non-bankruptcy law. Petitioner acknowledges that "secured claim," by contrast, is a bankruptcy classification under Section 506(a) and can be less than the full amount of the claim or lien if the property's value has decreased. Petitioner's logical reading of Section 722 underscores the inconsistency of its reading of Section 506(d). *See also infra* pp. 43–44.

2. *Congress chose to exempt other provisions, but not Section 506(d), from Section 506(a)'s operation.* Petitioner's theory is that "secured" status under Section 506(d) is determined by state law, rather than by Section 506(a), which defines that term in the very same section of the Code. But Congress understood that Section 506(a)'s definition of "secured claim" would apply throughout the Bankruptcy Code: "Throughout the bill, references to secured claims are only to the claim determined to be secured under [Section 506(a)], and not to the full amount of the creditor's claim." H.R. REP. NO. 95–595, at 356. When Congress wanted other Code provisions to apply to claims regardless of their secured status under Section 506(a)(1), it did something different from what it did in Section 506(d): it omitted the word "secured" or explicitly exempted the provision from Section 506(a)'s operation.

a. For instance, Section 363(k) authorizes a lienholder to credit-bid (that is, "offset [its] claim against the purchase price") at an auction of "property that is subject to a lien that secures an allowed claim," whether or not the claim remains secured in bankruptcy. 11 U.S.C. § 363(k). In contrast, Con-

gress referred to an "allowed *secured* claim" in Section 506(d).

b. Two other Code provisions show that Congress knew how to preclude Section 506(a) from operating on secured claims. First, Section 1111(b)(2) provides that if a creditor whose claim is of more than "inconsequential value" (and thus partially secured) exercises its election under this subsection, "then *notwithstanding section 506(a)* of this title, such claim is a secured claim, to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2) (emphasis added).

Second, in 2005 Congress expressly provided that "*section 506 shall not apply*" to purchase money security interests in recently purchased cars and other items. 11 U.S.C. § 1325(a)(*) (following § 1325(a)(9)) (emphasis added). Congress could have used similar language in Section 506(d) to accomplish petitioner's desired result, but chose not to do so.

"[W]hen Congress includes particular language in one section of a statute but omits it in another . . [,] this Court presumes that Congress intended a difference in meaning." *Loughrin* v. *United States*, 134 S. Ct. 2384, 2390 (2014) (internal quotation marks and alterations omitted); *see also United States* v. *Smith*, 499 U.S. 160, 167 (1991) (canon against implying additional exceptions when some are already expressly enumerated). If Congress had wanted to divorce Section 506(a) from Section 506(d), it would have said so expressly, as it did elsewhere.

3. *Petitioner's theory would negate several key limitations on a Code provision important to business reorganizations and liquidations.* Petitioner's read-

ing of Section 506 would override two important limitations on Section 1111(b): the requirement of an election for secured status and the exemption of interests of inconsequential value. App., *infra*, pp. 1a–2a (reprinting 11 U.S.C. § 1111).

First, Section 1111(b)(2) gives lienholders in chapter 11 proceedings the option to have their partially underwater, and thus undersecured, claims nevertheless treated as "secured claim[s] to the extent that such claim[s] [are] allowed." The undersecured creditor "may elect to forego its unsecured claim and have the entire amount of its claim treated as fully secured by the collateral." Steven R. Haydon et al., *The 1111(b)(2) Election: A Primer*, 13 BANKR. DEV. J. 99, 107 (1996). So nonrecourse lenders, who ordinarily could not enforce their liens against a debtor's assets other than the collateral, may elect to have their claims treated either as completely secured (but limited to the mortgaged property) or as partially unsecured (and so including a deficiency claim against the debtor's other assets). *Id.* Petitioner's reading of Section 506, however, would automatically treat *all* allowed underwater claims backed by liens as completely secured, regardless of any election. *Cf.* Pet. Br. 39 n.20 (noting creditor's election and citing § 1129(b)(2)(A)(i), which does not itself void liens).

Second, while creditors who hold partially underwater claims can ordinarily elect secured status, they cannot do so if their interests are "of inconsequential value." 11 U.S.C. § 1111(b)(1)(B)(i). Thus, this provision protects claims with value but not *completely* underwater claims. Completely underwa-

ter claims lose their secured status, even if the holders of those claims dissent and even if they receive no distribution of property in return. 124 CONG. REC. 34,007 (1978) (statement of Sen. DeConcini).

This inconsequential-value exception prevents "creditors with liens of no market value . . . [from] attempt[ing] to bargain or harass the debtor post-confirmation to secure greater value for their lien[s]." *In re Rosage*, 82 B.R. 389, 391 (Bankr. W.D. Pa. 1987). With nothing to lose, such creditors would refuse to consent until they had extracted payoffs exceeding their claims' current value. But "the value of [a] lien related to nuisance and legal harassment is not a value recognized in bankruptcy." *Id.*

Petitioner's reading would override this policy—the same policy underlying Section 506(d)—and let all such claims remain secured regardless of whether any value still supports the lien. "[T]he canon against surplusage is strongest when," as here, "an interpretation would render superfluous another part of the same statutory scheme." *Marx* v. *Gen. Revenue Corp.*, 133 S. Ct. 1166, 1178 (2013). Petitioner's reading would do more than just make Section 1111(b)'s provisions superfluous; it would negate the careful limitations that Congress imposed upon them.

II. *DEWSNUP*'S CAREFULLY LIMITED HOLDING, DECLINING TO VOID A PARTIALLY UNDERWATER FIRST MORTGAGE LIEN, DOES NOT EXTEND TO COMPLETELY UNDERWATER SECOND MORTGAGES

Instead of squarely focusing on the statutory text, petitioner relies almost exclusively on *Dewsnup*. But *Dewsnup*'s narrow holding cannot bear that enor-

mous weight. While *Dewsnup* found the term "allowed secured claim" barely ambiguous as applied to a partially secured claim, there is no such ambiguity in the context of the completely *un*secured claims here. Moreover, *Dewsnup* did not consider, and had no occasion to consider, any of the distinctive historical and policy arguments concerning valueless liens specifically. In particular, none of the *Dewsnup* litigants noted that this Court had upheld voiding completely valueless junior liens in bankruptcy nearly sixty years earlier. And when this Court considered a related issue in *Nobelman*, just one year after *Dewsnup*, it specifically relied on the presence of some value supporting a partially secured claim, to avoid preserving completely underwater mortgage liens.

A. *Dewsnup* Went Out of Its Way to Limit Its Holding to the Precise Situation Before It

1. *Why* Dewsnup *deviated from the statutory text.* *Dewsnup* acknowledged that the natural reading of Section 506 would void even the undersecured portion of partially underwater liens. Thus, had the Court been "writing on a clean slate, [it] might [have] be[en] inclined to agree with [the debtor] that" Sections 506(a) and (d) operate in tandem to reduce the mortgage lien to the value of the underlying collateral. 502 U.S. at 417.

But two policy considerations, plus its reading of the general historical treatment of liens in bankruptcy, persuaded *Dewsnup* to deviate from the natural reading of the text. 502 U.S. at 417–20. Still, the Court acknowledged that its reading of the stat-

ute was "not without its difficulty." *Id.* at 417. All of the Justices, both in the majority and dissent, conceded that this reading was difficult to square with the statutory text. *Id.* (majority opinion); *id.* at 422–23 (Scalia, J., dissenting); *see also Bank of Am. Nat'l Trust & Sav. Ass'n* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 461–63 (1999) (Thomas, J., concurring in the judgment).

2. Dewsnup *specifically avoided resolving whether completely underwater second mortgages are "secured claims."* In *Dewsnup*, the Court specifically reserved certain hypotheticals for future consideration: "Hypothetical applications that come to mind *and those advanced at oral argument* illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations." 502 U.S. at 416 (emphasis added). Thus, the Court took pains to "focus upon the case before [it] and allow other facts to await their legal resolution on another day." *Id.* at 416–17.

At oral argument, the debtor's counsel advanced two hypotheticals to illustrate the difficulties posed by the creditors' proposed rule. One was this very case, the problem of the completely underwater second mortgage: "[I]f you have a senior lienholder and a junior lienholder, if the junior lien is worthless, this provision allows the elimination of that junior lien so that the debtor can negotiate with the senior creditor and work out a plan for repayment over a period of time." 90–741 Oral Arg. Tr. 8–9.

In *Dewsnup*, unlike here, the creditors still had a secured claim supported by some (albeit partial) val-

ue, so the mortgage was still partially secured. The Court specifically limited its holding to the case of the partially secured claim disputed by the parties before it: "[W]e hold that § 506(d) does not allow *petitioner* to 'strip down' *respondents'* lien, because *respondents'* claim is secured by a lien and has been fully allowed pursuant to § 502." 502 U.S. at 417 (emphases added). The Court thus specifically avoided resolving or even commenting on the issue presented by a completely underwater second mortgage, as advanced hypothetically at the *Dewsnup* oral argument and as presented here.

Petitioner attempts to stretch *Dewsnup*'s holding well beyond these careful limitations. Indeed, petitioner nowhere quotes the Court's actual, fact-specific holding. Instead, petitioner quotes or cites the *Dewsnup* creditors' position more than a dozen times, as if it were the Court's holding. Br. 13 (twice), 19, 22 (four times), 24 (twice), 25, 26 (twice), 27. *Dewsnup* specifically declined to go so far, acknowledging the "difficulty" posed by the creditors' broad position. 502 U.S. at 417.

3. *Bootstrapping: One cannot rely on what* Dewsnup *did not hold.* Given *Dewsnup*'s own careful limitation of its holding, which explicitly avoided resolving the issue in this case, there is no basis for petitioner's invocations of reliance, legislative ratification, and *stare decisis*. *See* Br. 40–45. One cannot rely on what this Court has not done.

"Concepts of *stare decisis* in statutory interpretation apply to the *holdings* with which the case-by-case method of decision surrounds a statute. To rec-

ognize no differences between the [mortgage interests in *Dewsnup*] and those in issue here . . . would turn the case-by-case process against itself." *United Gas Improvement Co.* v. *Cont'l Oil Co.*, 381 U.S. 392, 404 (1965) (Harlan, J.) (emphases added). Justice Jackson's caution that "[g]eneral expressions transposed to other facts are often misleading" is particularly apt here, where *Dewsnup*'s historical and policy arguments falter in the context of completely underwater second mortgages. *Armour & Co.* v. *Wantock*, 323 U.S. 126, 133 (1944).

B. Though *Dewsnup* Found the Statutory Text Barely Ambiguous as Applied to a Partially Secured Claim, the Text Is Clear that a Completely Unsecured Claim Is Not an "Allowed Secured Claim"

The limited issue in *Dewsnup* was whether the debtor there could void the underwater portion of a partially underwater first mortgage lien. 502 U.S. at 411–12. Because the mortgage was undersecured, the creditor's claim was partially secured and partially unsecured under Section 506(a). There are two ways to view such a claim: Viewing it as separate secured and unsecured claims would have required voiding the unsecured, underwater portion of the lien under Section 506(d). Alternatively, under *Dewsnup*, one can view the claim as a single hybrid secured/unsecured claim, which remains secured in bankruptcy because it is still backed by collateral with some value. Though the latter approach does not fully sever the secured and unsecured claim components, either approach preserves a role for

Section 506(a)'s requirement of some current value as the foundation of secured status.

1. *Dewsnup* viewed "the contrasting positions of the respective parties and their *amici*" as "demonstrat[ing] that § 506 of the Bankruptcy Code and its relationship to other provisions of that Code do embrace *some ambiguities*." 502 U.S. at 416 (emphasis added). Given its policy concerns and sense of historical practice, *Dewsnup* found the term "allowed secured claim" barely ambiguous as applied to a mortgage supported by some value in the property. *Id.* at 417. The Court concluded that one could read the term broadly to include partially secured claims, but nowhere suggested that it could include completely *un*secured claims.

2. Here, by contrast, there is no equity to secure petitioner's claims. Petitioner concedes, as it must, that its claims are completely unsecured under Section 506(a), and that if foreclosure sales happened today, petitioner would reap nothing and its liens would be extinguished. Br. 11, 26. Indeed, many second mortgages (but few if any first mortgages) are completely unsecured. Because *Dewsnup* involved only a first mortgage, it had no occasion to consider this situation.

Outside of bankruptcy, if a mortgagor fails to pay its debt, the lien allows the mortgagee to foreclose on the home. But upon such a foreclosure and payment of the proceeds to the first mortgagee, there may well be nothing left over for the second mortgagee. Yet when the first mortgagee forecloses, the second mortgage lien is discharged, regardless of whether

the second mortgagee consented or received any payment. RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.1 (1997). Thus, in foreclosure, a completely underwater second mortgage is worthless. Because land is virtually always worth something, real property in practice never becomes completely valueless. So, absent a supervening lien, first mortgages do not sink completely underwater. Only second mortgages do.

In short, a completely unsecured claim "is not an allowed secured claim." 11 U.S.C. § 506(d). Unlike in *Dewsnup*, petitioner's claims are not at all secured, so Section 506(d) voids the liens. Nothing in *Dewsnup* calls for a different result.

C. This Court's Decision in *Nobelman* Confirms that Completely Underwater Mortgage Liens Are Void

One year after *Dewsnup*, this Court's decision in *Nobelman* confirmed the narrowness of *Dewsnup*'s holding. In *Nobelman*, the creditor and trustee advanced the same broad reading of *Dewsnup* that petitioner advances here: that every mortgage remains a perpetually secured claim, regardless of its value. Instead of accepting that broad reading of *Dewsnup*, this Court made clear that while bankruptcy courts cannot void partially underwater mortgage liens, they can void liens that are completely underwater.

The question presented in *Nobelman* was whether a chapter 13 debtor could use Section 506(a) to reduce the secured portion of a partially underwater mortgagee's claim down to the home's fair market value. 508 U.S. at 325–26. The creditor and the

trustee each devoted an entire part of its brief to *Dewsnup*, arguing that Section 506(a)'s definition of "secured claim" could not be used to void any lien under Section 506(d) or 1322(b)(2). 92–641 Am. Sav. Bank Br. 25–27; 92–641 Ch. 13 Trustee Br. 16–22, 44. Like petitioner here, the *Nobelman* creditor read "the *Dewsnup* Court [as] adopt[ing] the [*Dewsnup*] creditor's argument." 92–641 Am. Sav. Bank Br. 26. And both the creditor and the trustee argued, as petitioner does here, that Section 506(a) affects only the distribution of assets, not secured status generally. *Id.* at 13–14; 92–641 Ch. 13 Trustee Br. at 21–22.

This Court could easily have extended *Dewsnup* to resolve *Nobelman* by interpreting all mortgages as perpetually secured claims for purposes of Sections 506(d) and 1322(b)(2). After all, as petitioner argues here, a mortgage lien always secures some claim under nonbankruptcy law. Br. 19–20, 22.

But this Court rejected the creditor's and trustee's broad arguments, declining to unmoor other provisions of the Code from Section 506(a). As this Court explained, the debtors "were correct in looking to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim," i.e., whether it really is to be treated as "secured" or not. *Nobelman*, 508 U.S. at 328. Section 506(a) defines the phrase "secured claim" as a "term of art," and that term of art stands in contrast to the phrase "claim secured . . . by a security interest" in Section 1322(b)(2). *Id.* at 330–31.

Instead of detaching the other Code provisions from Section 506(a), this Court rested its holding on

the continued existence of value in the collateral to secure the lien. "[T]he bank is still the 'holder' of a 'secured claim,' *because petitioners' home retains $23,500 of value as collateral.*" *Id.* at 329 (emphasis added). Because the lien was still supported by enough value to provide partial security, it could not be voided. *Id.* at 331.

Moreover, *Nobelman* reasoned, trying to write down the unsecured portion of a partially underwater mortgage would have ripple effects on the creditor's other contractual rights in the mortgage, impinging on the creditor's remaining secured claim. A single note covers both the secured and unsecured components of a mortgage. Voiding the unsecured portion would necessarily alter the interest rate, monthly payment, term, or amortization schedule, which would also modify the secured portion of the mortgage. 508 U.S. at 331–32. "This conundrum" would be especially complex for adjustable-rate mortgages. *Id.* at 332. But voiding an entire mortgage lien poses no such problem.

Nobelman undermines petitioner's reading of Section 506(d). It clarifies *Dewsnup* by confirming that Section 506(a) determines the secured status of "secured claim[s]" throughout the Code. And it dispels petitioner's argument that Section 506(a) affects only the distribution of assets.[1] *Contra* Br. 11, 26.

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[1] The creditor in *Nobelman*, like the creditor here, argued that *Dewsnup* made clear that every mortgage remains a "secured claim" with a valid lien even if it is completely underwater, notwithstanding Section 506(a). At oral argument, several Members of this Court expressed doubts that the creditor's position on completely underwater mortgages was settled law.

32–33. Though *Nobelman* itself involved chapter 13, its understanding of Section 506(a) extends more broadly. *See* 11 U.S.C. § 103(a) (providing that the provisions of chapter 5 apply generally to chapters 7, 11, 12, and 13).

Following *Nobelman*, all eight courts of appeals to resolve the issue have held that *Nobelman* and Sections 506(a) and 1322(b)(2) authorize voiding completely underwater second mortgage liens in chapter 13. *In re Pond*, 252 F.3d 122, 126 (2d Cir. 2001); *In re McDonald*, 205 F.3d 606, 611 (3d Cir. 2000); *In re Davis*, 716 F.3d 331, 335–36 (4th Cir. 2013); *In re Bartee*, 212 F.3d 277, 291 (5th Cir. 2000); *In re Lane*, 280 F.3d 663, 668–69 (6th Cir. 2002); *In re Schmidt*, 765 F.3d 877, 881–82 (8th Cir. 2014); *In re Zimmer*, 313 F.3d 1220, 1226–27 (9th Cir. 2002); *In re Tanner*, 217 F.3d 1357, 1359–60 (11th Cir. 2000). *But cf. In re Woolsey*, 696 F.3d 1266, 1279 (10th Cir. 2012) (reserving the interpretation of § 1322(b)(2) "and its meaning for another day" because the petitioner had specifically refused to argue it). In claiming that Section 1322(b)(2) forbids voiding home mortgage liens, petitioner ignores this unanimous contrary authority. Br. 39.

One Justice asked: "[W]hat is the result if there is a second mortgage as to which there is no adequate security at all [because the first is partially underwater]? . . Is the second mortgagee a holder of a secured claim? . . . Even though the value of the property does not support any portion of his secured—any portion of his claim as a secured claim. It's difficult for me to square that with 506(a)." 92–641 Oral Arg. Tr. 24; *see id.* at 39–40; *see also id.* at 44–46.

Moreover, this unanimous authority belies petitioner's assertion that voiding completely underwater liens would disrupt second mortgagees' expectations. Br. 21, 44. Lien-voiding has been settled law for more than a decade. If the sky had fallen in the Eleventh Circuit or in the eight circuits that permit lien-voiding in chapter 13, petitioner and its amici would have cited abundant statistics to that effect.

D. Before the 1978 Bankruptcy Code, This Court Upheld the Power of Bankruptcy Courts to Void Valueless Junior Liens

1. *Pre-Code practice cannot cloud clear statutory text.* Though petitioner relies heavily on pre-Code practice, the statutory text is too clear to warrant recourse to it here. The Code "was intended to modernize the bankruptcy laws, and as a result made significant changes in both the substantive and procedural laws of bankruptcy." *Ron Pair*, 489 U.S. at 240 (citations omitted). "In particular, Congress intended 'significant changes from current law in . . . the treatment of secured creditors and secured claims.'" *Id.* (quoting H.R. REP. NO. 95-595, at 180 (1977)). In light of this revision, "pre-Code practice . . . cannot overcome that [statutory] language. It is a tool of construction, not an extratextual supplement." *Hartford Underwriters*, 530 U.S. at 10.

2.a. *Pre-Code practice voided completely underwater junior liens.* Even if one considers pre-Code practice, it only undermines petitioner's position. Petitioner claims that the 1898 Bankruptcy Act prevented courts from voiding liens. Br. 23, 28–29. But this Court's precedent is to the contrary.

Eight decades ago, this Court affirmed bankruptcy courts' power to void valueless junior mortgage liens as an essential way to adjust competing rights among multiple creditors. In one proceeding under the 1898 Act as amended, completely underwater junior mortgagees sought to hold up a reorganization because they would receive nothing "in respect to their claims." *620 Church St.*, 299 U.S. at 25, 26–27. The junior mortgagees asserted that the plan was unfair and inequitable, deprived them of their property rights, and conflicted with *Radford*, on which petitioner here likewise relies. *Id.*; *see* Br. 23, 24, 30–31, 35 n.17 (citing *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935)).

This Court rejected those claims. The amended 1898 Act protected only "'the realization of the *value* of the interests, claims or liens' affected." *620 Church St.*, 299 U.S. at 27 (emphasis added) (quoting § 77B of the Act). The collateral was worth less than the amount of the first mortgage bonds, so the second and third mortgages had no value. *Id.* at 26. "[T]he controlling finding [was] not only that there was no equity in the property above the first mortgage, but that petitioners' claims were appraised by the court as having 'no value.' *There was no value to be protected.*" *Id.* at 27 (emphasis added); *see also Wayne United Gas Co.* v. *Owens-Ill. Glass Co.*, 91 F.2d 827, 832 (4th Cir. 1937) (collecting cases); *In re Witherbee Ct. Corp.*, 88 F.2d 251, 253 (2d Cir. 1937).

Petitioner cannot dismiss these precedents simply as involving reorganizations rather than liquidations. *See* Br. 31–32. The Code explicitly provides that Section 506 applies broadly, in "case[s] under

chapter 7, 11, 12, or 13." 11 U.S.C. § 103(a). By contrast, when Congress wants to limit certain Code provisions to particular chapters, it does so expressly. *See, e.g.*, *id.* § 103(i).

In interpreting a different subsection of Section 506 in a chapter 7 case, this Court has relied on chapter 11 precedents. *Hartford Underwriters*, 530 U.S. at 10 (relying on *Ron Pair* and *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531 (1994)). Even petitioner recognizes the parallels between the chapters, repeatedly citing chapter 11 cases as generally applicable to this chapter 7 case. *See, e.g.*, Br. 7, 27, 30, 31, 37 (relying on *Travelers*, *203 N. LaSalle St.*, *United Sav. Ass'n*, *Butner*, *BFP*, *RadLAX*, and *Nordic Village*). The portion of *203 North LaSalle Street* quoted by petitioner, for instance, explicitly relies on a chapter 11 Code provision and other citations that refer specifically to reorganizations. *Compare* Br. 27, *with* 526 U.S. at 457.[2]

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[2] Indeed, the Code recognizes that because reorganizations and liquidations can involve overlapping concepts, the two cannot be segregated. For instance, chapter 11 proceedings are frequently used for liquidations in lieu of chapter 7. 11 U.S.C. § 1123(b)(4); Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 523–24 (1999). This Court has acknowledged the overlap between reorganizations and liquidations. *See Fla. Dep't of Rev.*, 554 U.S. at 37 n.2 ("Although the central purpose of Chapter 11 is to facilitate reorganizations rather than liquidations . . . , Chapter 11 expressly contemplates liquidations."); *CFTC* v. *Weintraub*, 471 U.S. 343, 353 n.6 (1985) ("While this [legislative history] reference is to reorganization, nothing in the Code or its legislative history suggests that the debtor's directors enjoy substantially greater powers in liquidation."); *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U.S. 216, 220

Thus, whether a case concerns a liquidation or a reorganization is immaterial for purposes of interpreting Section 506, which applies across the Code. Where a second mortgage is completely underwater, there is no value to protect, and bankruptcy courts have long had the power to void such valueless junior liens.

b. *Liens often do not survive bankruptcy.* Petitioner also greatly overreads the history relied on by *Dewsnup*. The precedent quoted by *Dewsnup* described the maxim as a generalization, not a hard-and-fast rule: "'*Ordinarily*, liens and other secured interests survive bankruptcy.'" *Dewsnup*, 502 U.S. at 418 (emphasis added) (quoting *Farrey* v. *Sanderfoot*, 500 U.S. 291, 297 (1991)). As then-Chief Judge Posner put it, petitioner is "mesmerized by" an "old saw" that "cannot be maintained without careful qualification, that liens pass through bankruptcy unaffected. They do—unless they are brought into the bankruptcy proceeding and dealt with there." *In re Penrod*, 50 F.3d 459, 461, 463 (7th Cir. 1995); *accord In re Lindsey*, 823 F.2d 189, 190 (7th Cir. 1987) (Posner, J.) (explaining that this "old saw . . . is no better than a half-truth"). Today, the maxim's continuing relevance is limited. As Judge Gorsuch has noted, "[w]hatever pre-[C]ode practice looked like, it would seem to have (at best) limited interpretive significance today, given that Chapter 7 indubitably permits liens to be removed in many situations." *Woolsey*, 696 F.3d at 1274 (citing *Harmon* v. *United States*, 101 F.3d 574, 581 (8th Cir. 1996) (collecting examples)).

(1936) ("[T]he end to be served was essentially the same[:] . . reorganization or liquidation or something akin thereto.").

Petitioner attempts to rely on *Long* v. *Bullard*, 117 U.S. 617 (1886). Br. 23, 28, 31, 35 n.17. *Long*, however, held simply that "a discharge in bankruptcy does not release real estate of the debtor from the lien of a mortgage" when the mortgagee had not participated in the bankruptcy proceeding. *Dewsnup*, 502 U.S. at 419 (citing *Long*, 117 U.S. at 620–21). Here, petitioner's mortgages *were* part of the bankruptcy proceedings, and petitioner could not have stayed out of them; the Code now empowers debtors, trustees, and sureties to pull creditors in. 11 U.S.C. § 501(b), (c); *see also Dewsnup*, 502 U.S. at 417–18. Moreover, *Long* says nothing about statutory voiding powers that might operate during the proceeding, before the discharge. Here, unlike in *Long*, the bankruptcy court brought an express lien-voiding statutory provision to bear.

E. *Dewsnup*'s Policy Considerations Are Largely Inapplicable to Completely Underwater Second Mortgages

Dewsnup acknowledged that its reading of Section 506(d) was strained, but justified it based on one historical and two policy considerations. 502 U.S. at 417–20. *Dewsnup* had no occasion to address how those considerations might apply to completely underwater second mortgages. As discussed, the historical record in this context does not support petitioner's argument, because this Court has long allowed bankruptcy proceedings to void completely underwater junior liens. Nor can petitioner rely on *Dewsnup*'s policy considerations; if anything, they favor voiding completely underwater mortgage liens.

1. Voiding valueless second mortgage liens benefits first mortgagees

Dewsnup's primary rationale was the need to prevent the debtor from gaining a "windfall" if the property later increased in value. 502 U.S. at 417. If a court reduced a lien to its current value, *Dewsnup* feared, even a slight increase in value would let the debtor—rather than the creditor—reap the future gain. *Id.* But here, any increase in value first and foremost benefits the first mortgagee.

Respondents' homes would have to nearly double in value before their respective first mortgagees' claims would be satisfied. Moreover, foreclosed homes typically sell at deep discounts below fair market value. *Infra* pp. 46–47. So property values would have to increase even more before there would be any value left over for a debtor, or a second mortgagee like petitioner. In this situation, there is usually nothing left over to give debtors a "windfall."

2. Voiding valueless liens keeps second mortgagees from holding up mutually beneficial workouts outside foreclosure, benefitting the housing market

Not only does voiding second mortgage liens give debtors few if any "windfalls," but it also prevents second mortgagees from exercising dubious hold-up power. Voiding valueless second mortgage liens is sometimes the only way to stop second mortgagees from obstructing mutually beneficial bargains between first mortgagees and debtors.

In order to avoid the costs of foreclosure, debtors and creditors frequently negotiate mutually benefi-

cial, consensual resolutions of troubled mortgages. Creditors typically prefer to avoid foreclosure because the process can take many months, result in substantial legal fees, and yield prices well below market value. Instead, a first mortgagee may strike a deal with a debtor, such as lowering the interest rate, extending the loan term, or writing down the principal balance. (These are often called "loan modifications" or "workout agreements.") These consensual resolutions are generally fast and sometimes let the debtor stay in the home instead of forcing the debtor to abandon it. First mortgagees often seek to arrange these workouts, so they can keep receiving payments toward the entire mortgage balance instead of foreclosing for pennies or dimes on the dollar.

But junior mortgagees often use completely underwater junior liens to block these agreements and extract payoffs. "[S]enior lienholders generally require the junior lienholder to affirmatively agree to subordinate their claim to the modified senior lien before [the senior lienholder will] agree[] to the [loan] modification." Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities*, 41 UCC L.J. 347, 370 (2009). Otherwise, the senior mortgagee's modification "would [go to] benefit the junior [mortgagee] because the borrower's improved financial position frees up additional cash flows to the second-lien holders." Sumit Agarwal et al., *Second Liens and the Holdup Problem in Mortgage Renegotiation* 5 (2014), *available at* http://tinyurl.com/HoldupAgarwal. In fact, many of the agreements that govern bundles of securitized mortgage loans do

not let senior mortgagees modify a loan without resubordinating the junior lien. *Id.*

The existence of completely underwater mortgages thus results in "a 'hold-up' problem." *See* Vicki Been et al., *Sticky Seconds—The Problems Second Liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J.L. & BUS. 71, 99 (2012). Because second mortgagees get nothing from a workout agreement or foreclosure, they have nothing to lose by holding up deals solely to "extract[] the largest monetary concession they can." Cordell et al. 368. These "demands can make the first lien holder less likely to modify or refinance its loan or to approve a short sale or [deed in lieu of foreclosure], because the demands make the workout too costly for the first lien holder," forcing homes into foreclosure. Been et al. 99.

Thus, as the chief economist at Moody's Analytics explained, "'[s]ubordinate liens have become the biggest hurdle to resolving the foreclosure crisis more quickly.'" Prashant Gopal & John Gittelsohn, *Second Loans Keep Houses in Limbo*, BUSINESSWEEK, July 30–Aug. 5, 2012, at 40, 41; *see also* Cordell et al. 368 ("A major impediment to refinancing and loss mitigation is the presence of junior liens . . . .").

The problem is likely to be particularly acute when the second mortgage is securitized (pooled with other mortgages, sliced into many layers, and sold off separately), which may make it impossible in practice to procure the consent of every interested party. The hold-up power exercised by second mortgagees can thus clog the housing market, creating a large backlog of homes in foreclosure instead of keep-

ing those homes occupied by homeowners who continue to make payments. Such raw power to hold up deals to extract payment is not a legitimate source of value protected by bankruptcy law. *Supra* p. 22.

Worse yet, homes awaiting foreclosure sales quickly fall prey to vandalism and crime, so they tend to lower the value of nearby homes significantly, ultimately contributing to neighborhood blight. *See* John Y. Campbell et al., *Forced Sales and House Prices*, 101 AM. ECON. REV. 2108, 2110, 2121, 2128 (2011) (empirical study finding that foreclosures, on average, lower the value of the foreclosed home by $44,000 and depress the value of nearby homes by between $148,000 and $477,000).

Thus, while voiding partially underwater first mortgage liens could hypothetically risk giving debtors windfalls, voiding completely underwater second mortgage liens is unlikely to do so. That is especially true where, as here, the second mortgage is deeply underwater. Instead, voiding those second mortgage liens helps first mortgagees, neighborhoods, and the housing market generally by promoting consensual workouts in lieu of foreclosure.

3. Second mortgagees' bargains already reflect their subordination to first mortgagees

Second mortgagees bargained for their more precarious security position beneath first mortgagees. They understood that they had no right to prevent foreclosure and would receive nothing in foreclosure if the collateral's value fell below the first mortgage's balance. So voiding completely underwater second

mortgage liens does not violate second mortgagees' bargains.

Before the housing crash, many homes had high loan-to-value ratios, frequently reaching "nearly 100%." Martin Feldstein, *How to Stop the Mortgage Crisis*, WALL ST. J., Mar. 7, 2008, at A15. In this case, Mr. Caulkett's two mortgages had a combined loan-to-value ratio of 100% when they were issued, and Mr. Toledo-Cardona's ratio was 103.6%. Such second mortgagees could foresee what came to pass: because loan-to-value ratios were so high, any drop in home values would immediately impair their loans' values and quickly make them valueless.

Dewsnup worried about voiding liens solely to benefit "other unsecured creditors . . . who had nothing to do with the mortgagor-mortgagee bargain." 502 U.S. at 417. But that concern does not apply when voiding the second mortgage lien benefits a first mortgagee, "who had [every]thing to do with the mortgagor–mortgagee bargain." *Id.*

Even outside of bankruptcy, if a first mortgagee forecloses on a home, the foreclosure sale extinguishes the second mortgage lien, and the second mortgagee receives no proceeds from the foreclosure sale. To compensate for their higher risk, second mortgagees demand more favorable terms than first mortgagees, such as higher interest rates. In 2009, for example, borrowers paid interest rates that were nearly twice as high for $30,000 home-equity loans (which are junior mortgages) as for traditional 30–year mortgages. Opp. 17 & n.3. Both greater rewards and greater risks, including the risk of lien

removal in foreclosure by first mortgagees, are central to second mortgagees' bargains.

Petitioner erroneously argues that voiding second mortgage liens "would be an enormous and unwarranted disruption of settled expectations," implying that it would raise mortgage costs substantially. Br. 44. But that claim is not supported by the empirical evidence. *See supra* p. 32. A recent empirical study found that rulings authorizing cramdowns of partially secured mortgages in bankruptcy did not substantially raise interest rates for homeowners. Joshua Goodman & Adam Levitin, *Bankruptcy Law and the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates*, 57 J.L. & ECON. 139, 141 (2014). This is likely because "lenders are [already] pricing in the risk of principal modification," whether by foreclosure, bankruptcy, or otherwise. *Id.* Thus, second mortgagees' bargains already reflect their subordinated status, and their higher interest rates already price in the expected risk of loss via foreclosure, lien-voiding, or simple nonpayment.

III. PETITIONER'S REMAINING ARGUMENTS ARE MERITLESS

A. Voiding Completely Underwater Liens Neither Conflicts with the Other Code Provisions Cited by Petitioner nor Renders Them Surplusage

1. Petitioner does not and cannot claim that our plain-language reading of Section 506(d) would make other provisions of the Code superfluous. The most it can claim is that *overruling Dewsnup* might arguably render other provisions superfluous or override

their limitations. Br. 20, 35–40. But petitioner attacks a straw man: we do not and have never argued that this Court need overrule *Dewsnup*. As long as *Dewsnup* remains good law, debtors cannot use Section 506(d) to void partially underwater liens. Thus, a debtor who wants to void a lien still attached to property with some value must turn to one of the other provisions cited by petitioner. Giving Section 506(d) its plain meaning renders neither these powers nor the limitations placed on them surplusage.

2. Moreover, the principal provision relied on by petitioner, Section 722, is distinct from Section 506(d) in three key respects. First, Congress enacted Section 722 to protect debtors from harsh state redemption laws governing personal property. *See, e.g.*, U.C.C. § 9–623(b) (requiring debtors to pay the *entire* amount owed in order to redeem property after default). In order to protect consumers, Section 722 expressly provides that its right of redemption survives "whether or not the debtor has waived the right to redeem under this section." Section 506(d) contains no such ban on waiver.

Second, in keeping with this consumer-protection policy, Congress titled Section 722 a "Redemption" provision. This provision, unlike Section 506(d), guarantees the debtor the right to maintain all title in the debtor's property under state law. In essence, Section 722, unlike Section 506, "amounts to a right of first refusal." H.R. REP. NO. 95–595, at 380–81; 6 COLLIER ON BANKRUPTCY ¶ 722.01 (16th ed. 2014). *But see* Pet. Br. 36 n.18.

Third, Section 722 authorizes a debtor to redeem "tangible *personal property* intended primarily for personal, family, or household use" that is security for "a dischargeable consumer debt" (emphasis added). *See supra* pp. 18–19. It does not apply to real property. Unlike real property, tangible personal property is seldom subject to multiple liens, so such liens will rarely be completely underwater.

3. Similarly, petitioner claims that reading Section 506(d) as voiding completely underwater liens would render Section 1322(b)(2) surplusage. Br. 39. But Section 1322(b)(2) applies broadly to modifying rights in chapter 13 plans, including the rights of holders of claims that were never secured by a lien. More importantly, it allows debtors, with court approval, "to modify the number, timing, or amount of the installment payments," as well as other terms such as installment charges. *Till* v. *SCS Credit Corp.*, 541 U.S. 465, 475 (2004) (plurality opinion); *accord* 8 COLLIER ON BANKRUPTCY ¶ 1322.06[1] (16th ed. 2014). Unlike Section 1322(b)(2), Section 506(d) grants no power to adjust these other terms and rights.

B. The Code Consistently Relies on Judicial Valuations at Specific Times

1. *Valuations, finality, and a fresh start.* Petitioner objects that bankruptcy courts should not void completely underwater liens because the Code supposedly manifests a "general aversion to reliance on judicial valuation" and because property values are "constantly shifting." Br. 27. Petitioner argues that relying on judicially determined valuations would

produce inequitable and "absurd result[s]," *id.*, but the Code's text, structure, and policies belie these assertions. The Code seeks to resolve creditors' claims promptly and finally in order to grant debtors a fresh start, "unhampered by the pressure and discouragement of preexisting debt." *Grogan* v. *Garner*, 498 U.S. 279, 286 (1991) (internal quotation marks omitted).

2. *Judicial valuations.* Congress determined that bankruptcy court valuations adequately protect junior lienholders' rights. Section 506 expressly contemplates a judicial valuation hearing: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." 11 U.S.C. § 506(a)(1). "[Section] 506(a) [provides] for a judicial valuation of the collateral to determine the status of the [creditor's] secured claim." *Nobelman*, 508 U.S. at 328. As the House Committee Report's commentary on this provision explained, "*[c]ourts will have to determine value* on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." H.R. REP. NO. 95–595, at 356 (emphasis added).

3. *Valuation at a specific time.* The Code routinely requires bankruptcy courts to value property of the estate at a specific time during the bankruptcy proceeding. Section 506 consistently uses the present tense, rather than the future tense, requiring a "[d]etermination of secured status" based on whether the claim "*is* a secured claim" or "*is not* an allowed

secured claim." 11 U.S.C. § 506(a)(1), (d) & heading (emphases added).

Other provisions of the Code consistently rely on judicial valuations at a specific time. *E.g.*, 11 U.S.C. § 502(b) (determining amount of claims "as of the date of the filing of the petition"); *id.* § 522(a)(2) (same, for valuing exempted property). For instance, the provisions of chapters 11, 12, and 13 instruct courts to value property "as of the effective date of the plan." 11 U.S.C. §§ 1129(a)(7)(A)(ii), (a)(7)(B), (a)(9)(B)(i), (a)(9)(C)(i), (b)(2)(A)(i)(II), (b)(2)(B)(i), (b)(2)(C)(i), 1225(a)(5)(B)(ii), 1228(b)(2), 1325(a)(5)(B)(ii).

4. *Safeguards Protect Creditors' Value.* Bankruptcy law provides a number of safeguards for creditors. Valuation is an adversarial process that lets creditors object to debtors' valuations of claims or property and present their own proposed valuations, supported by appraisals and expert testimony. FED. R. BANKR. P. 3012, 7001(2); *see also, e.g.*, *In re Old Colony, LLC*, 476 B.R. 1, 6–8 (Bankr. D. Mass. 2012).

Far from underestimating value, judicial valuations based on appraisals and comparable sales provide much more accurate assessments of fair market value than foreclosure sales outside of bankruptcy. "[Forced] sales are rushed, poorly advertised, done on a cash, not credit, basis, do not allow buyers to examine the property well, and may entail potential future litigation. All these factors reduce the potential field of buyers, reducing the price it will command." *Ehring* v. *W. Cmty. Moneycenter (In re Ehring)*, 900 F.2d 184, 188 n.2 (9th Cir. 1990). In addition, fair market value does not reflect the high

costs and delays associated with foreclosure sales. Thus, an empirical study of 1.8 million Massachusetts home sales between 1987 and 2009 found that in foreclosure, homes sell at an average discount of 27%. Campbell et al. 2109–10, 2114. Bankruptcy valuations thus safeguard completely underwater mortgages far more than actual foreclosure sales would.

C. The Code Draws Lines Based on Dollar Values

Petitioner claims that it is "absurd" and arbitrary to draw distinctions based on the current value of the property. Br. 27. But there is a significant difference between partially underwater and completely underwater mortgages. *Nobelman* feared that voiding only part of a mortgage lien could create a "conundrum" of rewriting "the mortgage contract" to "recalculat[e] the amortization schedule" and the like, having ripple effects on the remaining secured portion of the mortgage. 508 U.S. at 331–32. Voiding an entire mortgage lien, by contrast. does not.

Here, as elsewhere, Congress can and must draw lines. Often, "the legislature must necessarily engage in a process of line-drawing" and put some people with "almost equally strong claim[s] . . . on different sides of the line." *FCC* v. *Beach Commc'ns, Inc.*, 508 U.S. 307, 315–16 (1993) (internal quotation marks omitted). "[T]he fact [that] the line might have been drawn differently at some points is a matter for legislative, rather than judicial, consideration." *Id.* (internal quotation marks omitted).

Congress has drawn such value-based lines throughout the Bankruptcy Code. Section 1111(b) is one example, *supra* pp. 21–22, and there are dozens of others. A debtor whose monthly income is $1 above the applicable median family income in his state is subject to means testing in chapter 7, and any chapter 13 plan must ordinarily span five rather than three years. 11 U.S.C. §§ 707(b)(7)(A), 1322(d)(1), 1325(b)(4). A chapter 7 debtor whose projected disposable income over the next five years is $12,475 triggers a presumption of abuse, while one with a projected disposable income of $12,474.99 may not. *Id.* § 707(b)(2)(A)(i). Such predictions of future income are necessarily imprecise; incomes and values fluctuate up and down, but nonetheless need to be assessed. Dozens of other Code provisions are likewise triggered by precise dollar thresholds, most of which increase every three years. *See* Memorandum from Judge Thomas F. Hogan, Admin. Office of the U.S. Courts, *Automatic Adjustment of Certain Dollar Amounts in the Bankruptcy Code and Official Bankruptcy Forms* (Mar. 13, 2013), *available at* http://tinyurl.com/HoganMemo. Here, drawing the line at completely underwater mortgages is particularly reasonable because such mortgages would yield nothing in foreclosure.

D. The Legislative History Does Not Contradict the Clear Text

1. *Legislative history cannot cloud the statute's clear text.* Legislative history is of no moment when interpreting clear provisions of the Bankruptcy Code. "In such a substantial overhaul of the [bankruptcy laws], it is not appropriate or realistic to ex-

pect Congress to have explained with particularity each step it took." *Ron Pair*, 489 U.S. at 240. Thus, unless there is genuine ambiguity in the text, there is no need to resort to legislative history. *RadLAX*, 132 S. Ct. at 2073; *Patterson*, 504 U.S. at 761; *Barnhill* v. *Johnson*, 503 U.S. 393, 401 (1992). "[I]t would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of a statute." *Harrison* v. *PPG Indus., Inc.*, 446 U.S. 578, 592 (1980). "In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark." *Id.*

At least in the context of completely underwater second mortgages, the Bankruptcy Code's text is too clear to warrant recourse to legislative history. A completely underwater mortgage "is an unsecured claim," not "an allowed secured claim," so a completely underwater "lien is void." 11 U.S.C. § 506(a)(1), (d).

2. *Petitioner's legislative history does nothing to resolve the issue.* Petitioner's legislative-history arguments are, in any event, makeweights. Br. 33–34. The drafting history quoted does nothing to "ma[k]e clear that a lien was not voided unless a party in interest had objected to the underlying claim and the court had affirmatively disallowed it." Pet. Br. 33. The language quoted by petitioner includes the same requirement as the current statute that a "lien is void" unless its underlying claim is "an allowed secured claim." It simply raises, but cannot answer, the question presented here: whether "allowed se-

cured claim" in Section 506(d) means the same thing as "allowed . . . secured claim" in Section 506(a). The existence of two exceptions pertaining to disallowance in no way restricts voiding liens due to their unsecured status.

Petitioner also quotes the House Report for the proposition that "Subsection (d) *permits* liens to pass through the bankruptcy case unaffected." H.R. REP. NO. 95–595, at 357 (emphasis added); Br. 34. That observation adds nothing to petitioner's argument. At the risk of stating the obvious, the word "permits" is permissive, not mandatory. *See* BALLENTINE'S LEGAL DICTIONARY AND THESAURUS 120 (1995) (listing "permissive" as the antonym of "compulsory").

Of course, as *Long* held, liens are not automatically voided by bankruptcy discharges. They may pass through bankruptcy unaffected, unless and until the bankruptcy court brings Section 506(d) or some other express lien-voiding provision to bear. Section 506(d) permits a lien to pass through bankruptcy so long as it is supported by a claim that is both allowed and secured.

Petitioner's other snippets of legislative history fare no better. The main Senate Report quoted by petitioner, Br. 34, interpreted the Senate's version of Section 506(d), which was ultimately rejected in favor of the House version. 124 CONG. REC. 33,997 (1978) (statement of Sen. DeConcini). The House's references to *Long* and *Radford* are consistent with our reading of those cases as merely recognizing that by itself, "[t]he bankruptcy discharge will not prevent enforcement of *valid* liens." H.R. REP. NO. 95–

595, at 361 (emphasis added); Pet. Br. 35 n.17; *supra* pp. 33, 36. That truism simply raises the question in this case: whether the lien remains valid or whether "such lien is void" under Section 506(d). It is petitioner that adds the gloss, outside of quotation marks, that "liens pass through bankruptcy unaffected." Br. 35 n.17.

E. The Constitution's Bankruptcy Clause Empowers Congress to Authorize Voiding Completely Underwater Liens

Finally, petitioner suggests that voiding valueless junior liens is unconstitutional. Br. 23–24. But the Constitution's Bankruptcy Clause gives Congress broad power to distribute the property of debtors and release them from legal liability, even by "impair[ing] the obligation of contracts." *Hanover Nat'l Bank* v. *Moyses*, 186 U.S. 181, 188 (1902). There is no clear-statement requirement or presumption against Congress's exercise of this express power. *Contra* Pet. Br. 31 (citing *BFP*, which laid down no such broad rule). "Bankruptcy proceedings constantly modify and affect the property rights established by state law." *Wright* v. *Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938).

Petitioner cites *Radford* as having found an unconstitutional taking. Br. 24. But petitioner neglects to mention that this Court disavowed *Radford* nine years later as an example of when this Court "may fall into error." *Helvering* v. *Griffiths*, 318 U.S. 371, 400, 401 & n.52 (1943). Moreover, in *Radford*, the statute's infirmity was not that it voided valueless liens, but that it abridged *valuable* liens *retroac-*

tively and let debtors purchase their property for "much less than the appraised value." 295 U.S. at 589, 591–92. As petitioner's own amicus concedes, "cases subsequent to *Radford* seem to focus on protection of lien *value* existing at the time of bankruptcy." Community Bankers Amicus Br. 13–14.

Secured creditors have a right to protect their liens *only* "to the extent of the value of the property. There is no constitutional claim of the creditor to more than that." *Wright* v. *Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940) (citations omitted); *accord 620 Church St.*, 299 U.S. at 25, 27 (rejecting the same argument based on *Radford*). Here, petitioner concedes that its liens are unsupported by any value. Br. 26. There is thus no constitutional concern.

CONCLUSION

The judgments of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

Section 1111 of Title 11 of the United States Code provides:

§ 1111. Claims and interests

(a) A proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under section 521(a)(1) or 1106(a)(2) of this title, except a claim or interest that is scheduled as disputed, contingent, or unliquidated.

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless—

> **(i)** the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or
>
> **(ii)** such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if—

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

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BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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IN THE

Supreme Court of the United States

Nos. 13-1421, 14-163

BANK OF AMERICA, N.A.,

Petitioner,

v.

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF FOR PETITIONER

If respondents' and their amici's submissions make one thing clear, it is that respondents can prevail only if *Dewsnup* is overruled. Respondents' central contention is that this Court's decision in *Dewsnup* resolved only the fact-bound dispute presented by the parties to that case, and that this Court's *reasoning* in *Dewsnup* should be ignored. But no fair reading of *Dewsnup* can limit it to partially, rather than wholly, underwater liens—as every court of appeals to address the question, other than the Eleventh Circuit, has held.

Respondents' arguments for "distinguishing" *Dewsnup* are, in reality, arguments for overruling it *sub silentio*. Their reading of the statutory text was considered, and expressly rejected, in *Dewsnup* itself. And none of the features of wholly underwater junior liens respondents identify in any way undermines *Dewsnup*'s applicability to such liens.

Some amici are more forthright in asking this Court to overrule *Dewsnup*. But neither respondents nor amici offer any justification for casting aside statutory *stare decisis* here. They cannot dispute that, over the more than 20 years since *Dewsnup*, Congress has acquiesced in this Court's holding. Instead, they simply contend that *Dewsnup* was wrongly decided. And they argue that voiding underwater junior liens would be good policy. The first contention is both incorrect and insufficient to warrant overturning established precedent. The second is appropriately directed to Congress, not this Court.

I. *DEWSNUP* CONTROLS THIS CASE

A. *Dewsnup* Permits No Distinction Between Partially And Wholly Underwater Liens

1. Respondents contend (at 25) that *Dewsnup* resolved only "the case of the partially secured claim disputed by the parties before it," and has no broader application. In attempting to limit *Dewsnup* to its facts, they ignore *Dewsnup*'s *reasoning*, which dictates the outcome of this case. Like any decision of this Court, *Dewsnup* did not merely resolve the dispute of "the parties before it." Rather, it adopted a specific reading of §506(d). And—contrary to respondents' suggestion—that reading did *not* turn on the fact that the lien in question was only partially underwater. Rather, *Dewsnup* held that §506(d) voids only liens securing

claims *that have not been allowed.* That holding precludes respondents' argument here.

The Court first laid out the conflicting constructions of the statute advocated by the parties. Debtors contended that

> §§506(a) and 506(d) are complementary and to be read together. Because, under §506(a), a claim is secured only to the extent of the judicially determined value of the real property on which the lien is fixed, a debtor can void a lien on the property pursuant to §506(d) to the extent the claim is no longer secured and thus is not "an allowed secured claim." In other words, §506(a) bifurcates classes of claims allowed under §502 into secured claims and unsecured claims; any portion of an allowed claim deemed to be unsecured under §506(a) is not an "allowed secured claim" within the lien-voiding scope of §506(d).

502 U.S. 410, 414-415 (1992). That is, debtors made precisely the argument respondents make here (at 12-16): A claim's "secured" status under §506(d) turns on the value of the collateral as determined under §506(a).

The creditor respondents and the United States argued, on the other hand, that a claim is "secured" under §506(d) if it is "secured by a lien with recourse to the underlying collateral," regardless of the collateral's value:

> [T]he words "allowed secured claim" in §506(d) need not be read as an indivisible term of art defined by reference to §506(a).... Rather, the words should be read term-by-term to refer to any claim that is first, allowed, and, second, se-

> cured. *Because ... the claim at issue here has been "allowed" pursuant to §502 of the Code and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of §506(d)* .... This reading of §506(d) ... gives the provision the simple and sensible function of voiding a lien whenever a claim secured by the lien itself has not been allowed.

502 U.S. at 415–416 (emphasis added).

After laying out these contrasting approaches, the Court unequivocally adopted the creditors' approach:

> We conclude that respondents' ... position, ... although not without its difficulty, generally is the better ... approach[]. Therefore, we hold that §506(d) does not allow petitioner to strip down respondents' lien, because *respondents' claim is secured by a lien and has been fully allowed pursuant to §502.*

502 U.S. at 417 (emphasis added).[1]

The Court expressly rejected debtors' position that "the words 'allowed secured claim' must take the same meaning in §506(d) as in §506(a)." 502 U.S. at 417. And it therefore rejected debtors' claim that §506(d) permitted stripping liens securing allowed claims "to the extent that [the claims] become 'unsecured' for purposes of §506(a)." *Id.* at 420.

Dewsnup's holding could hardly be clearer: §506(d) does not void liens if the underlying claim is "deemed to be unsecured under §506(a)" based on the collateral's

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[1] In light of that holding, respondents' assertion (at 25) that the Court "specifically declined" to endorse the creditors' position, and their criticism of petitioner for quoting the Court's description of the creditors' position, are mystifying.

value. 502 U.S. at 415. Rather, §506(d) voids a lien only when the underlying claim "*has not been allowed.*" *Id.* at 416 (emphasis added). Respondents' contention (at 25) that *Dewsnup* is limited to cases in which a mortgage-holder's claim is "partially secured" under §506(a) simply misrepresents this Court's decision: *Dewsnup* makes plain that a claim's "secured" status for purposes of distribution under §506(a) has *no bearing* on whether the creditor's lien is void under §506(d).

Respondents do not acknowledge *Dewsnup*'s actual holding because it is fatal to their case. *Dewsnup*'s construction of §506(d) permits no distinction between partially and wholly underwater liens. As Judge Posner put it for the Seventh Circuit, "*Dewsnup* ... holds that section 506(d) does not allow the bankruptcy court to squeeze down a fully valid lien to the current value of the property to which it's attached." *Palomar* v. *First Am. Bank*, 722 F.3d 992, 994 (7th Cir. 2013). It makes no difference, he explained, that "[the] debtors want to reduce the value of the lien to zero"; valid liens cannot be reduced to the property's current value regardless of what that value is. *Id.*; *see In re Talbert*, 344 F.3d 555, 560 (6th Cir. 2003) ("[*Dewsnup*'s] reasoning for not permitting 'strip downs' in the Chapter 7 context applies with equal validity to ... a Chapter 7 'strip off.'"); *Ryan* v. *Homecomings Fin. Network*, 253 F.3d 778, 782 (4th Cir. 2001) (same). Indeed, even the Eleventh Circuit admitted that *Dewsnup* "seems to reject" its reasoning. *Caulkett* Pet. App. 12a.

To be sure, this Court in *Dewsnup* employed the traditional common-law method of "focus[ing] upon the case before [it] and allow[ing] other facts to await their legal resolution on another day." 502 U.S. at 416-417;

see Resp. Br. 24.[2] But it does not follow that *Dewsnup*'s *reasoning* is not binding in a case coming within the scope of that reasoning. "When an opinion issues for the Court, it is not only the result but also those portions of the opinion necessary to the result by which we are bound." *Seminole Tribe of Fla.* v. *Florida*, 517 U.S. 44, 67 (1996). Here, moreover, the portion of *Dewsnup* necessary to the result was an interpretation of specific statutory text. As this Court has repeatedly recognized, courts "can[not] give the same statutory text different meanings in different cases." *Clark* v. *Martinez*, 543 U.S. 371, 386 (2005). *Dewsnup* held that the phrase "secured claim" in §506(d) means any claim secured by a lien that is valid under nonbankruptcy law. Section 506(d) cannot have a different meaning here.

2. Respondents' textual argument (at 12-16) merely resurrects contentions *Dewsnup* expressly repudiated. Respondents' central premise is that, "[t]o determine whether a claim is 'secured'" for purposes of §506(d), one looks to §506(a), which provides that "if the value of the creditor's interest in the property is zero[,] ... the creditor's claim 'is an unsecured claim.'" Resp. Br. 12, 13. But—as discussed above—that is precisely the argument debtors made, and this Court rejected, in *Dewsnup*. 502 U.S. at 415 (summarizing debtors' argument that "any portion of an allowed claim deemed to be unsecured under §506(a) is not an 'allowed secured claim'" under §506(d)); *id.* at 417, 420 (rejecting that ar-

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[2] Respondents claim (at 8) that the Court "expressly declined to reach" the "hypothetical" question whether a wholly underwater junior lien could be stripped off. Not so. At oral argument, debtors' counsel stated that debtors' reading of §506(d) "allows the elimination of [a] junior lien." *Dewsnup* Tr. 8-9, *available at* 1991 WL 636262. The Court, however, rejected debtors' reading.

gument). Respondents cannot resurrect that argument now.

Moreover, respondents' reading of §506 makes no sense even on its own terms. Section 506(a) provides that a claim "is a secured claim *to the extent of* the value" of the creditor's security interest (emphasis added). Because respondents purport to accept (at 10) that "*Dewsnup* is the law" as to partially underwater liens, however, their reading must ignore the phrase "to the extent of" and turn §506(a) into an on-off switch: If the collateral's value is $1, the creditor keeps its entire lien, but if the collateral's value is $0, it loses its entire lien. That interpretation has no basis in the statute's text, and again makes that text mean different things in different circumstances—when determining whether a claim is "secured" for distribution purposes, "to the extent that" has effect, but when determining whether a claim is "secured" for lien-stripping purposes, it does not.[3]

Respondents' interpretation also leads to absurd results. To be sure, the Code often requires line-drawing; to determine whether a debtor's income is too high to proceed in chapter 7, one must set a presumptive income cut-off. Resp. Br. 48. But respondents' reading of §506 does not merely draw a line; it creates a cliff. Respondents cannot explain why a creditor with a $1 million claim secured by collateral worth $1 on the

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[3] Respondents fail to address the problems their interpretation creates for §506(a), but admit (at 16) that it requires reading "to the extent that" in §506(d) to modify the word "allowed"—but not "secured"—in the phrase "allowed secured claim." Even if that reading does not create surplusage (*cf. id.*), if the word "secured" is an independent basis for lien-voiding, as respondents contend, their reading is both ungrammatical and inexplicable.

valuation date should keep its entire $1 million lien, but that same creditor should lose its entire lien if the collateral's value on that date is $1 less.

3. Respondents' supporting arguments fare no better. Respondents contend (at 17-18) that *Dewsnup*'s reading renders the word "secured" in §506(d) surplusage. But that simply rips a page from the *Dewsnup* dissent. *See* 502 U.S. at 426 (Scalia, J.). Fully aware of this "difficulty," the Court chose a reading consistent with "the pre-Code rule that liens pass through [liquidation proceedings in] bankruptcy unaffected," given no evidence that Congress intended to abrogate that rule. *Id.* at 417.

Respondents similarly contend (at 17-19) that *Dewsnup*'s reading of "secured claim" in §506(d) gives the phrase a different meaning than it has elsewhere in the Code. The Court considered this argument as well, and found it insufficient to overcome other, more powerful indicia of Congress's intent. 502 U.S. at 417 & n.3 (reserving question whether "'allowed secured claim' ha[s] [a] different meaning in other provisions of the Bankruptcy Code"); *see id.* at 421-423 (Scalia, J., dissenting). In any event, where other evidence supports such a reading, "[i]dentical language" may "convey varying content ... even in different provisions of the same statute." *Yates* v. *United States*, 135 S. Ct. 1074, 1082 (2015) (plurality).

Finally, respondents wrongly contend (at 20-22) that §506(d) must be read to void wholly underwater liens to avoid a supposed conflict with §1111(b). Section 1111(b) provides that where a chapter 11 debtor retains a partially underwater creditor's collateral under a plan of reorganization, the creditor may (unless its interest in the collateral is of "inconsequential value") exempt

its claim from bifurcation under §506(a) and have the claim treated as fully secured. Under chapter 11's cram-down provisions, if the creditor makes that election, the plan must provide that the creditor retain its lien until its allowed claim is paid in full. 11 U.S.C. §1129(b)(2)(A)(i).

There is no conflict here. Reading §506(d) as *Dewsnup* did—to void only liens securing disallowed claims—would not "automatically treat *all* allowed underwater claims backed by liens as completely secured, regardless of any election" (Resp. Br. 21). Indeed, it would not affect the operation of §1111(b) or any of its limitations at all. Section 1111(b) is an express exception to the bifurcation of *claims* under §506(a). Section 506(d) has no effect on the treatment of creditors' *claims*; it governs only the disposition of *liens*. Accordingly, however §506*(d)* is read, §506*(a)*'s bifurcation of claims into secured and unsecured portions would still apply in any case in which a creditor does not or cannot make the §1111(b) election. In that case, chapter 11's cram-down provisions would permit a plan to pay the partially secured creditor only the value of its collateral, as long as the substantive and procedural protections chapter 11 provides in such circumstances are satisfied. 11 U.S.C. §1129(b)(2)(A).[4]

4. Finally, respondents wrongly contend (at 28-32) that *Nobelman* v. *American Savings Bank*, 508 U.S. 324 (1993), "made clear that while bankruptcy courts cannot void partially underwater mortgage liens, they can void liens that are completely underwater."

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[4] Respondents also contend (at 19-20) that §506(d) is not (like §1111(b)) an express exception to §506(a). But because §506(d) does not affect the treatment of claims under §506(a), such an exception would make no sense.

This argument distorts *Nobelman*, which does not address §506(d) at all, still less suggest that it is limiting *Dewsnup*'s holding.

Nobelman interpreted a different statutory provision altogether—§1322(b)(2). Chapter 13 permits debtors, under certain circumstances, to strip underwater liens. 11 U.S.C. §1325(a)(5)(B); Pet. Br. 38-39. However, §1322(b)(2) provides that a chapter 13 plan may not "modify the rights of [a] holder[] of ... a claim secured only by a security interest in real property that is the debtor's principal residence." The question in *Nobelman* was whether, despite §1322(b)(2), a chapter 13 debtor could use §506(a) to bifurcate a mortgage lender's partially underwater claim and strip down its lien under §1325(a)(5)(B), thus paying the lender only the current value of the house. 508 U.S. at 325-326.

The debtors argued that because §1322(b)(2) protects holders of "claim[s] secured ... by" a lien on a principal residence, it did not bar modification of the portion of a claim that would be deemed "unsecured" for distribution purposes under §506(a). *Nobelman*, 508 U.S. at 328. The Court *rejected* that argument. It explained that "[b]y virtue of its mortgage contract with petitioners, the bank is indisputably the holder of a claim secured by a lien on petitioners' home." *Id.* It noted that §506(a) provided for a judicial valuation of the bank's secured claim, but observed that "even if we accept petitioners' valuation, the bank is still the 'holder' of a 'secured claim,' because petitioners' home retains $23,500 of value as collateral." *Id.* at 328, 329. The Court concluded that the rights "'bargained for by the mortgagor and the mortgagee'" "are [not] limited by the valuation of its secured claim," and that the bank was entitled to retain its lien until paid in full. *Id.* at 329, 330 (quoting *Dewsnup*, 502 U.S. at 417).

Respondents' reliance on this discussion is puzzling, given that it nowhere discusses §506(d) or suggests that it is narrowing *Dewsnup*. *Nobelman* merely held that §1322(b)(2) does not permit a debtor to strip down a partially underwater home mortgage lien. Respondents read *Nobelman* to turn on the fact that the lien was supported by collateral with present value, but it is not at all clear that the collateral's value was necessary to *Nobelman*'s holding. Indeed, the Court observed that "the bank [was] indisputably the holder of a claim secured by a lien" on the debtors' house "[b]y virtue of its mortgage contract" with the debtors. 508 U.S. at 328.

In short, *Nobelman* did not require this Court to resolve the question whether §1322(b)(2) applies to wholly underwater mortgages. Nor should the Court address the question here, because §1322(b)(2) is not at issue in this case. And nothing in *Nobelman* remotely undermines *Dewsnup*'s holding regarding §506(d). *See Ryan*, 253 F.3d at 782 (*Nobelman* does not "contradict[] or modif[y] in any respect the clear holding of *Dewsnup*").

B. Pre-Code Practice And Creditors' Nonbankruptcy Rights Permit No Distinction Between Partially And Wholly Underwater Liens

1. *Dewsnup* explained that, "[a]part from reorganization proceedings, no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." 502 U.S. at 418-419. Respondents (at 32-36) contend that this discussion is inapplicable to wholly underwater junior liens because under pre-Code practice, such liens *were* stripped off. That is untrue. As *Dewsnup* stated, before the Code's enactment, provisions of the *reorganization* chapters permitted lien-

stripping in some circumstances. But bankruptcy law has never permitted a debtor to strip a valid lien in a liquidation proceeding while keeping the collateral.[5] Neither respondents nor amici have identified a single such case.

Respondents' discussion of pre-Code cases is thus irrelevant. Respondents rely primarily on *In re 620 Church Street Building Corp.*, 299 U.S. 24 (1936). At the outset, *Church Street* did not even address lien-stripping in the sense relevant here—it did not involve the strip-off of an underwater junior lien on property *being retained by the debtor*. Rather, *Church Street* was a garden-variety application of the absolute priority rule. There, the first lienholders' claim exceeded the value of the debtor's assets. Under the plan of reorganization, all the debtor's assets were transferred to the first lienholders; the debtor's old owners received nothing; and junior lienholders likewise received no distribution.

This Court affirmed, noting that junior lienholders' entitlement to a distribution from the estate was limited to the value of their security interests—zero. *Church Street*, 299 U.S. at 26-27 (relying on Pub. L. No. 73-296, §77B(b)(5), 48 Stat. 911, 914 (1934)). There is nothing surprising, or contrary to *Dewsnup*, in that.

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[5] Respondents criticize (at 36) *Dewsnup*'s citation of *Long* v. *Bullard*, 117 U.S. 617 (1886), for this proposition, arguing that *Long* states only that a secured creditor can stay out of the bankruptcy. But that is the point. A secured creditor must participate in liquidation proceedings only if it wants a distribution from the estate; otherwise, it can rely on its lien, because valid liens survive bankruptcy. That remains true today. *See In re Tarnow*, 749 F.2d 464, 466 (7th Cir. 1984) (Posner, J.) ("One purpose of section 506(d)(1) is simply to codify the rule of *Long* v. *Bullard* ... permitting liens to pass through bankruptcy unaffected.").

Then as now, in reorganization proceedings, if a senior class of creditors is not paid in full, junior creditors and equity-holders receive no payment from the estate, and the transfer of assets to senior creditors can extinguish junior creditors' liens on those assets. *See Bank of Am. Nat'l Trust & Sav. Ass'n* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 444-445 (1999) (discussing history of absolute priority rule).[6] But that is irrelevant to this case: Petitioner here is not seeking any payment from the bankruptcy estates, or to retain a lien on assets that are being transferred to senior creditors or sold to a third party, but only to retain its liens while the debtors retain their houses.

As a rule, the principle of absolute priority prevented debtors from retaining property for themselves while stripping off creditors' liens. But to the extent that the 1898 Act provided authority for lien-stripping on property retained by the debtor, it did so *only* in the reorganization chapters. For example, the Frazier-Lemke Act, as amended, provided such authority in the context of farmer relief. *See* Pub. L. No. 73-486, §75(s), 48 Stat. 1289, 1289-1291 (1934); *Wright* v. *Union Central Life Ins. Co.*, 311 U.S. 273 (1940).[7] And later, some

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[6] Respondents' other cases (also reorganizations) similarly involved application of the absolute priority rule. *Wayne United Gas Co.* v. *Owens-Ill. Glass Co.*, 91 F.2d 827, 832 (4th Cir. 1937); *In re Witherbee Ct. Corp.*, 88 F.2d 251, 252-253 (2d Cir. 1937).

[7] *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935), held an earlier version of the Act to be a taking. Respondents criticize (at 51-52) *Dewsnup*'s citation of *Radford*. But *Dewsnup* (and petitioner) cited *Radford* not primarily for its constitutional holding, but for its recognition that pre-Code practice, outside certain reorganization provisions, did not permit lien-stripping. Petitioner is not contending here that Congress cannot constitutionally strip underwater liens, merely that it did not do so in §506(d).

courts interpreted the reorganization provisions of chapter XII of the Bankruptcy Act to permit a debtor to keep its property and extinguish a mortgagee's lien by paying it the property's appraised value. *See, e.g.*, *In re Pine Gate Assocs.*, 1976 WL 359641 (N.D. Ga. Oct. 20, 1976).[8] Notably, neither statutory provision distinguished between strip-downs and strip-offs.

By contrast, in pre-Code liquidation proceedings, the only liens valid under nonbankruptcy law that could be voided were preferences, fraudulent transfers, and certain judicial and statutory liens obtained within the four months before the bankruptcy filing. Act of July 1, 1898, §§60, 67, 30 Stat. 544, 562, 564-565. Pre-Code liquidation practice simply did not permit voiding or otherwise modifying liens solely because they were underwater—even if they were completely underwater. *Dewsnup*, 502 U.S. at 418-419.

Because their only authority for lien-stripping is reorganization cases, respondents are forced to argue that there is no meaningful distinction between reorganizations and liquidations. But the distinction is perhaps the most basic in bankruptcy law. In a liquidation, the debtor's assets are sold or abandoned; the funds realized go to pay creditors, and the debtor receives a discharge. Pet. Br. 6-10. In a reorganization, by contrast, the debtor's assets are not liquidated. In chapter 11, the debtor may reorganize as a new going concern owned by the creditors, in which case the assets can generate a reorganization surplus for creditors' benefit.

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[8] *Pine Gate* prompted the enactment of §1111(b) of the Code, which permits a partially secured creditor to avoid that result by electing to have its claim treated as fully secured. *In re B.R. Brookfield Commons No. 1 LLC*, 735 F.3d 596, 599-600 (7th Cir. 2013); *supra* Part I.A.3.

In chapter 13, the debtor similarly keeps his assets, but is required to commit all his disposable income during the plan period to pay creditors. 11 U.S.C. §1325(b)(1). Chapter 11 and 13 plans cannot be confirmed unless creditors will receive at least as much as they would in a liquidation. *Id.* §§1129(a)(7), 1325(a)(4). The ability to strip liens, under certain circumstances, in reorganizations is part of that very different bargain between debtor and creditor, and is balanced against the creditor's ability to share in the reorganization surplus. *Palomar*, 722 F.3d at 995.

Respondents also claim (at 33-34) that the distinction between reorganizations and liquidations is irrelevant because §506 applies to all chapters of the Bankruptcy Code. That misses the point. It is not §506 that enables lien-stripping in chapters 11 or 13, but the provisions specific to those chapters, which expressly authorize lien-stripping subject to carefully delineated limitations. 11 U.S.C. §§1129(b), 1325(a)(5). Likewise, as discussed above, where lien-stripping was permitted under the Bankruptcy Act, it was accomplished by provisions of the Act specific to reorganization. There are no such provisions, then or now, for liquidation proceedings.

2. Respondents next contend (at 36-42) that what they call *Dewsnup*'s "policy considerations"—really, *Dewsnup*'s explanation of secured creditors' basic rights—do not apply to wholly underwater junior liens. This is also wrong.

In rejecting debtors' argument for lien-stripping, *Dewsnup* explained that "[t]he practical effect of [that] argument is to freeze the creditor's secured interest at the judicially determined valuation," depriving the creditor of "any increase in the value of the property by the time of the foreclosure sale." 502 U.S. at 417. Out-

side bankruptcy, however, "the creditor's lien stays with the real property until the foreclosure"; "[t]hat is what was bargained for by the mortgagor and the mortgagee." *Id.*

That reasoning applies with equal force to senior and junior liens, regardless of the value of the collateral securing them. Contrary to respondents' assertions, junior liens are not "valueless" simply because they are wholly underwater. The value of real property generally increases over time. And as senior mortgages are paid down, more equity is created for a junior lienholder. A junior lien that is wholly underwater today thus may not be so tomorrow.[9]

It is true, as respondents emphasize, that if a house with a wholly underwater junior lien were sold in foreclosure today, the junior lienholder would not recover anything. But what respondents ignore is that the houses here are *not being sold.* The debtors are keeping the houses, but want to do so free of their mortgages. Just as in *Dewsnup*, that would deprive the creditor of any increase in the value of the property before it is sold. The junior creditor, like the senior creditor, has a nonbankruptcy right to have its lien stay with the real property until a sale. Permitting the junior lienholder to retain its lien in this situation thus does not give the lienholder better treatment than it would receive outside bankruptcy, but merely the *same* treatment to which it is entitled outside bankruptcy.

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[9] Respondents speculate (at 40) that because the two liens at issue here are deeply underwater, the Bank will likely never realize anything on the loans. But the Bank has hundreds of thousands of junior loans in its portfolio, and some of those that are underwater will almost certainly regain equity in the near term, just as millions of underwater loans have done in the last few years. Pet. Br. 16-17.

Similarly, it is irrelevant that "[s]econd mortgagees bargained for their ... position beneath first mortgagees." Resp. Br. 40. To be sure, junior lienholders are subordinate to senior lienholders. But it does not follow that junior lienholders' interests should also be subordinate to the *debtor's*. As the Sixth Circuit put it: "[A]s in the case of a 'strip down,' a 'strip off' would rob the mortgagee of the bargain it struck with the mortgagor" and would "carry the risk of a 'windfall' to the debtors should the value of the encumbered property increase" prior to sale. *Talbert*, 344 F.3d at 561. *Dewsnup*'s reasoning thus "applies with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off.'" *Id.* at 560.

II. RESPONDENTS' AND AMICI'S INVITATION TO OVERRULE *DEWSNUP* SHOULD BE REJECTED

As demonstrated above, *Dewsnup*'s interpretation of §506(d) permits no legal or logical distinction between partially and wholly underwater liens. This Court's analysis can and should end there.

Although respondents claim (at 10, 43) that they are not asking the Court to revisit *Dewsnup*, the vast majority of their arguments for "distinguishing" the decision are—as also demonstrated above—thinly disguised arguments for overruling it. Some amici are more forthright and openly call for overturning *Dewsnup*. Both the tacit and the explicit invitations to overrule *Dewsnup* should be rejected.

A. Respondents And Amici Offer No Reason To Abandon Statutory *Stare Decisis*

Neither respondents nor amici offer any reason why this Court should abandon the long-standing principle of statutory *stare decisis* here. *Dewsnup* has been

the law for nearly a quarter century. Respondents do not dispute that, by preserving §506(d) over that period—while making extensive alterations to the Bankruptcy Code as a whole and §506 in particular—Congress has acquiesced in *Dewsnup*'s interpretation of the statute. Pet. Br. 40-45. Overruling that interpretation now would improperly do what Congress has chosen not to do.

Nor do respondents meaningfully contest that millions of loans have been made, and priced, in reliance on *Dewsnup*'s holding—an additional reason, if one were needed, not to change course now. Secured debt, including home mortgages, provides borrowers with credit at lower cost than unsecured debt precisely because the creditor can look to its lien for repayment if the debtor defaults. Mann, *Explaining the Pattern of Secured Credit*, 110 Harv. L. Rev. 625, 683 (1997).[10]

Rather, respondents and amici simply contend—expressly or implicitly—that *Dewsnup* was wrongly decided. Even if that were so—and it is not—"mere demonstration that the overruled opinion was wrong" is no basis for overturning precedent. *Hubbard* v. *United States*, 514 U.S. 695, 716 (1995) (Scalia, J., concurring). "[O]therwise the doctrine [of stare decisis] would be no doctrine at all." *Id.*

In any event, *Dewsnup* was correctly decided—as Congress's acquiescence in the decision suggests. *First*, the language of §506(d) as originally enacted in

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[10] Respondents claim (at 42) that lien-stripping in chapter 7 would not raise the cost of credit "substantially." But the study they cite concluded that lien-stripping in chapter 13 *did* increase the cost of credit. Goodman & Levitin, *Bankruptcy Law and the Cost of Credit*, 57 J. L. & Econ. 139, 156 (2014).

1978 confirms *Dewsnup*'s interpretation. Pet. Br. 33-34. It provided:

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, *unless (1) a party in interest has not requested that the court determine and allow or disallow such claim* under section 502 of this title; or (2) such claim was disallowed only under section 502(e) of this title.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §506(d), 92 Stat. 2549, 2583 (emphasis added). Although respondents ignore the italicized language (at 49-50), it is significant. Under §502(a) of the Code, then and now, a claim is "deemed allowed" unless a party in interest objects. The italicized language provides that liens securing such "deemed allowed" claims cannot be voided. It would make no sense if liens securing claims that are "deemed allowed" because no party objected to them could not be voided at all, but liens securing claims that are *affirmatively allowed* because a party objected and was overruled could be voided based on the value of the collateral. The *only* way to make sense of the italicized provision is to read §506(d) as *Dewsnup* did, to void only liens securing disallowed claims.[11] Respondents have no answer to this point.

The legislative history bolsters that interpretation. The House Report stated unequivocally that "if a party in interest requests the court to determine and allow or

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[11] Although Congress amended the exceptions to §506(d) in 1984, those "[t]echnical and clarifying" amendments do not alter the basic point—as respondents do not dispute. *See* Pet. Br. 34 n.16. The current exceptions are worded differently, but still pertain only to claims that have not been "allowed." 11 U.S.C. §506(d)(1), (2).

disallow the claim secured by the lien under section 502 and the claim is not allowed, then the lien is void *to the extent the claim is not allowed*." H.R. Rep. No. 95-595, at 357 (1978) (emphasis added). Otherwise, "[s]ubsection (d) permits liens to pass through the bankruptcy case unaffected." *Id.*; *see also Tarnow*, 749 F.2d at 466. Respondents' answer (at 50)—that the word "permits" is permissive—is no answer at all. The House Report explained the specific circumstances under which §506(d) voids liens; it did not, as respondents would have it, make the meaningless statement that §506(d) permits liens to pass through bankruptcy unaffected except where it does not.

Second, reading §506(d) to strip all liens to the current value of the collateral would render the provisions of the Bankruptcy Code that *do* address lien-stripping nonsensical. Pet. Br. 35-39.

As petitioner explained (at 35-37), on that reading of §506(d), §722, which permits lien-stripping in narrow circumstances on exempt or abandoned personal property, would be superfluous. Respondents argue (at 43) that §722 differs from §506(d) because it is a "[r]edemption" provision, but a lien-stripping reading of §506(d) would permit a debtor to redeem all liened-up property—not just the narrow category in §722—by paying the lender the property's current value. *See* Pet. Br. 36 n.18. And while it is true that §722 includes a prohibition on waiver and §506(d) does not (Resp. Br. 43), that does not explain why Congress would have crafted an elaborate lien-stripping provision for certain personal property when §506(d) already automatically stripped all liens to the value of the property. Finally, that §722 does not apply to real property (Resp. Br. 44) merely underscores that it is a narrow provision whose

existence would make no sense in a world in which §506(d) itself stripped liens.

Likewise, §1325(a)(5)(B)'s careful limitations on lien-stripping under a chapter 13 plan would be rendered meaningless if §506(d) stripped liens. Pet. Br. 38-39. And §1322(b)(2)'s provision exempting holders of mortgages on principal residences from such lien-stripping would similarly be gutted. Pet. Br. 39. Again, respondents have no answer to these points. They argue (at 44) that §1322(b)(2) "applies broadly to modifying rights in chapter 13 plans," including rights of holders of unsecured claims, but that misses the point; it is §1322(b)(2)'s *exception* protecting mortgagees from such modification that would be rendered useless if §506(d) itself stripped liens.[12]

B. Respondents' And Amici's Policy Arguments Provide No Basis To Depart From *Dewsnup*

Finally, respondents (at 37-40) and amici resort to a variety of attacks on second mortgages as a product and on the banking industry generally, inviting this Court to overturn its precedent and rewrite the Bankruptcy Code in the interest of what they believe to be good housing or financial policy.

For example, they contend that voiding wholly underwater junior liens would benefit senior lienholders, and thus the housing market, because it would smooth the path to consensual modifications of senior mortgages. Other amici argue that stripping off underwater

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[12] Although §1322(b)(2)'s exception also protects mortgagees with liens on principal residences from modification of other ancillary rights, its central objective is to ensure that such mortgagees retain their most important right—the right to enforce their liens. That objective would be thwarted if §506(d) took that right away.

junior liens might require financial institutions to change the way they account for their mortgage portfolios, which in turn might affect applicable capital requirements. Some go so far as to suggest that this Court should read §506(d) to void underwater junior liens to punish the Bank and other lenders for purported misconduct leading to the housing crisis.

These arguments do not warrant extended discussion. As an initial matter, the suggestion that preservation of junior liens does nothing more than permit junior lenders to "hold up" senior lenders attempting to modify loans is wrong. As discussed above, preserving junior liens enables unpaid junior lenders to access the value of their collateral if it increases in the future. That, in turn, helps to ensure the continued availability of consumer credit. *See, e.g.*, *Nobelman*, 508 U.S. at 332 (Stevens, J., concurring) (noting that "favorable treatment of residential mortgages was intended to encourage the flow of capital into the home lending market"). It is also worth noting that Bank of America has a substantial portfolio of senior mortgages and regularly negotiates modifications with borrowers. Its decision to contest the stripping of its junior liens should demonstrate that preserving such liens is not unduly harmful to senior lenders.

Far more importantly, however, whether preserving junior mortgages is good or bad policy is not a question for this Court. Nor does the economic disruption caused by the financial crisis provide a basis for the Court to curtail the rights of mortgage-holders in bankruptcy. In the last several years, Congress has considered, and declined to enact, many proposals for permitting debtors to strip underwater mortgages in bankruptcy. Pet. Br. 43-44. Congress has also delegated the authority to regulate financial institutions to the ap-

propriate agencies. Respondents' and amici's invitations to this Court to appoint itself the arbiter of such questions should be rejected.

CONCLUSION

The judgments below should be reversed.

Respectfully submitted.

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In the Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Eleventh Circuit

BRIEF OF BANKRUPTCY LAW PROFESSORS ROBERT M. LAWLESS, BRUCE A. MARKELL, AND JOHN A. E. POTTOW AS *AMICI CURIAE* IN SUPPORT OF AFFIRMANCE

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QUESTION PRESENTED

Should *Dewsnup v. Timm*, 502 U.S. 410 (1992), be extended to exempt a completely underwater second mortgage from lien avoidance under section 506(d) of the Bankruptcy Code?

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are three leading scholars of bankruptcy, commercial, and business law who have been teaching, researching, and writing about bankruptcy law for decades. They seek to provide the Court with a fuller description of the legal rules, history, and policies affected by this case.

Robert M. Lawless is the Max L. Rowe Professor at the University of Illinois College of Law and is an elected member of the American Law Institute, a conferee of the National Bankruptcy Conference, and a fellow of the American College of Bankruptcy. He is also co-author of a leading casebook on secured credit.

Bruce A. Markell is a former bankruptcy judge and currently the Jeffrey Stoops Professor of Law at Florida State University and co-author of four casebooks in bankruptcy, contracts, secured transactions, and securitization. He is a member of the Board of Editors of *Collier on Bankruptcy*, and an elected member of the American Law Institute, a conferee of the National Bankruptcy Conference, and a fellow of the American College of Bankruptcy, where he currently serves as its Scholar in Residence.

John A. E. Pottow is the John Philip Dawson Collegiate Professor of Law at the University of Michigan Law School, a member of the International

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[1] Respondents have filed with this Court a blanket consent to *amicus* briefs. Petitioner has furnished a written consent to the filing of this brief, and a copy of that consent has been filed with this Court concurrently with the filing of this brief. No counsel for a party authored any part of this brief. No person, other than *amici* and their counsel, has made a monetary contribution toward the preparation or submission of this brief.

Insolvency Institute, and a co-author of a leading textbook on bankruptcy law.

SUMMARY OF ARGUMENT

When debtors can't pay their bills, state law allows their creditors to grab their assets in an uncoordinated and chaotic manner. What few assets there are go to the swift, while the uninformed and cautious take nothing. This process destroys asset value, which not only hurts debtors, but the debtors' other creditors as well. Congress enacted the Bankruptcy Code to address this imbalance and potential for waste. Through its operation, the Code seeks to maximize returns to *all* creditors, not just the aggressive, and to offer debtors a better chance to pay their debts and rehabilitate their finances.

To achieve these goals, the Code treats secured creditors and unsecured creditors differently. Secured creditors are those whose loans to the debtor come with collateral. In the event the debtor cannot repay the debt, the secured creditor can look to that property for repayment. A mortgage provides exactly this kind of secured claim. If the debtor defaults on the debt, the secured creditor (mortgagee) can secure payment on the debt by foreclosing on the debtor's home. Unsecured creditors, on the other hand, don't have this option. They are paid only if anything is left after the secured creditors have liquidated their collateral. The Code's entire apparatus is designed to ensure fairness in dividing the debtor's property among these secured and unsecured creditors.

In this case, Bank of America wants to turn that careful balance upside down. The bank asks this Court to create a valuable asset that the market and the Code

regard as worthless. The bank is a junior lienholder on an underwater mortgage, meaning that the value of the home does not even cover the secured claim of the senior creditor. The Code's plain language treats junior lienholders in this situation, like Bank of America, as unsecured creditors. 11 U.S.C. § 506(a).

Bank of America asks this Court to redefine the nature of its claim. The bank wants its lien to be an "allowed secured claim," *id.*, that survives the bankruptcy process. The only conceivable reason for seeking such legal alchemy is so the bank can extract value from the debtor and other creditors by impeding the orderly financial resolution that the Code is specifically designed to provide. The bank argues that the Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), compels this result.

The U.S. Court of Appeals for the Eleventh Circuit disagreed, concluding that *Dewsnup* did not apply. *In re Toledo-Cardona*, 556 F App'x 911, 912 (11th Cir. 2014) (unpublished opinion). *Dewsnup* held that in cases where the value of the underlying home covers some but not all of a lien, the undersecured creditor can still retain its legal claim on the property after bankruptcy. Creditors whose liens are completely devoid of value, the lower court held, cannot receive the same treatment. *Id.* (following *Folendore v. U.S. Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989)).

Bankruptcy law scholars Robert M. Lawless, Bruce A. Markell, and John A. E. Pottow, file this brief to urge the Court to affirm the lower court's sensible conclusion. They explain why Bank of America's arguments are inconsistent with the Code's plain language, history, and fundamental policies.

To reverse the reasoning of the judgment below—that holders of mere allowed unsecured claims cannot bootstrap into becoming treated as secured creditors—would subvert essential elements of the Code's basic architecture, namely: (1) enforcing the secured creditor's bargain that it must look to the value of the collateral for repayment, (2) ensuring equal treatment of all unsecured creditors, (3) minimizing the potential for holdout and hostage value to derail voluntary debt adjustments inside and outside bankruptcy, and (4) in consumer cases, according debtors finality in resolving their financial distress and a fresh start through discharge. *Dewsnup* should not be extended to bring about this result. Alternatively, *Dewsnup* should be overruled outright as a long-overdue error correction in bankruptcy jurisprudence.

ARGUMENT

I. The Bankruptcy Code Already Provides More Benefits to Junior Creditors Than They Would Receive Under State Law

A. Bank of America's Lien Under State Law Is Worthless

Bank of America holds a junior lien against Respondent Caulkett's home. Because the value of his home has fallen substantially since the loan was issued, the value of the junior lien is zero. The home's value isn't even enough to pay back Caulkett's senior creditor. If that senior creditor foreclosed on the house tomorrow in response to Caulkett's default, Bank of America would receive nothing. More importantly, the senior creditor's decision to foreclose would wipe out Bank of America's lien, forever extinguishing its (worthless) claim on the collateral. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.1. (1997).

Bank of America knows this. Because "the present value of the collateral is less than the amount outstanding on senior mortgages, if the houses were sold today, Bank of America would obtain no recovery." Pet. Br. 26. But the bank and its supporting *amici* argue that affirming the lower court somehow presents Caulkett a windfall that deprives the bank its due.[2] The bank argues that the Code requires it to retain its lien and hopes that the market correction that rendered its lien worthless

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[2] The "windfall" argument only applies to an individual debtor; a corporate debtor—such as a commercial real estate owner—can never have a windfall because it gets no discharge in liquidation. 11 U.S.C. § 727(a)(1).

will somehow, some day, correct itself sufficiently for the bank to recoup some of its investment. In the meantime, the bank's worthless lien should continue to cloud the property's title, preventing the senior lienholder and Caulkett from reaching any settlement.[3]

State law cuts off Bank of America's desire to play the market. Under state law, junior lienholders get nothing if a foreclosed property's sale price leaves a senior creditor undercompensated. This is why junior lienholders charge much higher interest rates. The benefit of the bargain for junior lienholders like Bank of America is that in exchange for charging more for the second mortgage, the junior lienholder has a higher risk of ending up without a security interest in the property in the event it is wiped out at foreclosure. Under state law, a junior lienholder is subject to the whims of the market, and, perhaps more importantly, the control of the senior lienholder. If the debtor defaults under the senior lien, the senior lender has a categorical right to foreclose; the junior lender has no say in the matter.

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[3] The Loan Syndications and Trading Association (LSTA), *amicus* in support of Bank of America, contends in passing that these liens are not economically worthless because there is "a secondary market" where LSTA members "frequently purchase debt" that is "often secured by a secondary lien." Brief for Loan Syndications and Trade Association at 1. *Amici* law professors do not dispute that there are secondary debt markets; *amici* argue only that there is no evidence that there is a market for *underwater* liens, the kind at dispute in this case. Worthless loans—without "value" in the parlance of the Code—might conceivably trade in some jurisdictions where they have been sanctioned, but they could only trade in the majority of others (where they have not been sanctioned) by only the most risk-tolerant speculators willing to take the chance their liens will not be avoidable under a binding judicial interpretation of section 506(d).

Even if the junior lienholder feels that a foreclosure occurs during an inopportune dip in the housing market, there is no recourse under state law. Once the senior lienholder forecloses, the junior lien is gone, and title is cleansed.

B. The Code Already Protects Bank of America's Junior Lien

Bank of America and its *amici* argue that affirming the lower court's decision would somehow use bankruptcy to deprive Bank of America of its legal property rights created under state law. This claim is mystifying, because the Code is much more generous to underwater junior lienholders than applicable state foreclosure law discussed above.

The key lies in the valuation of the collateral. Under state law, value is determined subject to the mechanistic process for foreclosure, where the junior lienholder has effectively no input in the process. Not so in bankruptcy. To value the junior lienholder's interest, the debtor must bring a motion, and the bankruptcy judge will perform a valuation that avoids the often punishing fire sale valuations that occur in foreclosures. Fed. R. Bankr. P. 3012. This bankruptcy valuation process can include expert testimony and provides ample space for a junior lienholder to argue that a forced liquidation would undervalue the home, and that the "true" value would render part of the secondary lien secured for purposes of the Code. *Id.*

In other words, although section 506—the section at issue in this case—separates secured from unsecured claims, the process by which those claims are separated differs dramatically from the regimented strictures of state law. The parties in bankruptcy court, including the

junior lienholder, can litigate their claims in a way that the foreclosure process does not accommodate. Individualized judicial valuation hearings in bankruptcy give the junior lender a much fairer shot at capturing any value than a state-law foreclosure.

Bank of America thus can already protect itself through the bankruptcy valuation process if it believes the market is undervaluing its underwater lien. And in fact, if it believes the bankruptcy valuation process itself is insufficient, it can go further. It can purchase an asset that it believes the market and the bankruptcy court have both undervalued by offering to buy it in bankruptcy for more than the determined aggregate value of the allowed secured claims. 11 U.S.C. § 363(f). Any trustee would jump at the deal.

But, of course, acquiring real estate is risky. Prices go down as well as up. And here is the essential problem of Bank of America's position: it wants this Court to allow it access to a risk-free investment. If the price goes up, it still has its nondischargeable lien. If it goes down, the trustee or the debtor—not Bank of America—takes the hit. What the junior lienholder could not secure in the market, and what it could not secure through the bankruptcy valuation process, it wants to receive by rewriting the Code.

A fundamental principle of bankruptcy law is that the Code should not alter state law entitlements absent a necessary bankruptcy law purpose. *See Butner v. United States*, 440 U.S. 48 (1979) (refusing to craft a special rule for mortgagees in bankruptcy to give them a right to rents they do not have under state law). According a free option to a junior lienholder does not just deviate from state law, it is antithetical to the purposes of bankruptcy law.

II. Bank of America Asks the Court to Grant It "Hostage Value" for Its Otherwise Worthless Liens

One might wonder why an underwater second lienholder would fight to protect a worthless lien. The answer is not in the lien's intrinsic market value, which is zero. Instead, it lies in indirect value. Even a worthless lien can allow its holder to derive some value from the property. This is the lien's "hostage value," which is both economically inefficient and inconsistent with the aims of the Code.

A leading secured credit casebook clarifies the distinction between market value and hostage value. "The usefulness of property as collateral will ultimately depend on (1) how much value the creditor can extract from it after default (will it bring anything at resale?), and (2) how much leverage the creditor can derive from its ability to deprive the debtor of the property (how much will the debtor be willing and able to pay to keep it?)." Lynn M. LoPucki & Elizabeth Warren, SECURED CREDIT 22-23 (7th ed. 2012). As explained above, the first factor in this case has already been determined: zero. Bank of America and all other junior lienholders on underwater properties must therefore rely on this second factor—the lien's ability to make the debtor or other creditors buy its holder off to clean title to the property.

This second type of value is called a property's "hostage" or "holdout value." *See* Anthony T. Kronman, *Contract Law and the State of Nature*, 1 J. L. ECON & ORG. 5, 15-18 (1985). Many secondary liens provide their holders substantial hostage value over homeowners and their primary creditors notwithstanding the lack of market value. Homeowners face real costs associated

with the disruptions of losing their homes, such as moving expenses and employment relocation, and so will pay a ransom to avoid these costs. The sentimental attachment many homeowners have to their homes would only magnify the effect of this distortion.

The ability of a secondary lienholder to force a foreclosure, post-bankruptcy—*even though a successful foreclosure will bring it absolutely no economic benefit*—enables it to extract payment from a homeowner who wants to prevent that foreclosure. In a sense, the junior lienholder on an underwater mortgage is simply playing an expensive game of chicken. The disproportionate value that homeowners attach to staying in their homes is exactly the target for these junior lienholders. Such lienholders, who don't really want to incur the costs of foreclosure, are simply hoping the homeowner will blink first.

The debtor's other creditors also suffer from the worthless liens that remain attached to a property, clouding the property's title and stymieing alternative arrangements between the senior lienholder and the homeowner. *See generally* Vicki Been, Howell Jackson, & Mark Willis, *Sticky Seconds—The Problems Second Liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J.L. & BUS. 71 (2012) (discussing underwater junior lienholders' pernicious role in workouts). This reality stems from the fact that even the most worthless junior lien can prevent deeds in lieu of foreclosure and short sales—two commonly used mechanisms to reach out-of-court resolutions of distressed mortgages—from taking place.

A deed in lieu of foreclosure allows a homeowner (the mortgagor) to convey property to its lender in full satisfaction of the debt without going to court. That is,

the homeowner turns over the keys (and the deed), and the lender no longer seeks to recover from the loan. If a home is worth less than the senior mortgage, a deed in lieu of foreclosure can be an efficient, cost-effective method for satisfying the senior lender and relinquishing the debtor's claim to title. But the deed in lieu of foreclosure is essentially a private transaction between borrower and lender and as such cannot eliminate other liens on the property besides the one held by the primary lender. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 8.5 cmt. B (1997). Although a junior lienholder can get nothing and have its lien erased in a formal foreclosure, it can still prevent the easier option of an out-of-court deed in lieu of foreclosure simply by saying "no" (or, more accurately, demanding a payment to say "yes").

Similarly, a short sale occurs when the lender agrees that the homeowner can sell the property to a third party for less than the amount owing on the mortgage free of the lender's claim. In short sales, the lender avoids the delay and costs of foreclosure and gets the market price the short-sale purchaser is willing to pay. The homeowner gains a complete or partial release from any deficiency, and title to the property is again cleared. But here, as with deeds in lieu of foreclosure, the junior lienholder can prevent a short sale entirely. The result is that the junior lienholder can extract payment from either the senior lienholder or the debtor to facilitate the short sale by threatening to prevent this expedited disposition of the underwater home by refusing to convey clean title to the purchaser.

Thus, the underwater junior lienholder acts as a sort of nuisance plaintiff who files a frivolous claim and must be bought off by the senior creditor if the costs of

requiring full foreclosure instead of deeds in lieu of foreclosure, short sales, or even refinancings with the debtor exceed the payoff demanded by the gadfly to go away. Exploitation of this hostage value harms both debtors and senior lenders alike. Both suffer rent extractions to junior lienholders that the Code is designed to prevent.[4]

One reason the Code evinces such hostility toward hostage value is the multi-party nature of bankruptcy proceedings. Consider a commercial firm with vital machinery that has been tailored to its own purposes. On a secondary market, this machinery will have little value. But if the debtor loses its machinery, it loses much more than the resale value. It may indeed lose the value of the entire enterprise. A lienholder could extract an extravagant premium from the debtor to prevent repossession and concomitant factory shutdown.

Outside bankruptcy, that hostage value is simply unpleasant for the debtor—simply a product of the contracting parties' negotiation. If the debtor grants a lien on the specialized machinery to get cheap credit, so be it. But in bankruptcy, the threat of hostage value is devastating. Every dollar a debtor pays to satisfy a lienholder's hostage value is a dollar that does not go to pay other creditors. The Code aims to neutralize, even eliminate, these kinds of zero-sum contests. For exactly this reason, the Code mostly protects only the "objective" value of the collateral itself, not the hostage

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[4] *Hostage value* is the liquidation bankruptcy cousin to the bane of reorganization bankruptcy: *holdout value*. The Code combats that related economic impediment to bankruptcy goals by allowing the vote of a creditor class to bind all class members to a reorganization plan. *See* 11 U.S.C. §§ 1126(c), 1129.

value premium of a "subjective" excess. Section 1129(b)(2)(A), for example, allows secured creditors to receive the "value of [the secured creditor's] interest" in the debtor's property, not the subjective value of the asset to the debtor. *See also* 11 U.S.C. § 1225(a)(5)(B) (secured creditor receives the amount of the "allowed secured claim"); *id.* § 1325(a)(5)(B) (same). Doing so carefully balances the rights of secured creditors with all other claimants in the debtor's estate.

III. This Court's Precedents Do Not Support the View that "Liens Pass Through Bankruptcy"

A. Liens Do *Not* Pass Through Bankruptcy; They Pass Through Bankruptcy Only if the Code Permits Them to Stay in Place

Bank of America argues that it is entitled to its economically disruptive, inefficient, and atextual reading of the Code because of a supposedly overarching and ancient principle of bankruptcy law that "liens, including underwater liens, ride through chapter 7 bankruptcy unaffected." Pet. Br. 44. For support, it cites the Court's decision in *Dewsnup*, 502 U.S. at 417-18.

Although *Dewsnup* announced its understanding of historical practice as favoring a policy that allowed liens to survive bankruptcy, *id.* at 418, this conclusion is only partially true and dangerously misleading, especially so when quoted as a general aphorism.

In fact, liens are altered, capped, subordinated, and even wholly avoided in bankruptcy proceedings all the time. The list of Code provisions that alters liens is dizzying. The automatic stay of section 362 stops a secured creditor from enforcing its lien, and the secured creditor is not compensated for the delay in realizing on

its collateral. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1992). Under section 364(d), a bankruptcy court can under some circumstances award a lender who lends to the debtor after the filing of the bankruptcy petition a "superpriority" lien that trumps existing liens on property of the estate. A lien can be avoided as a preference under section 547 or a fraudulent transfer under section 548. Section 522(f) allows debtors to avoid some liens that impair exemptions on certain assets. The trustee might avoid a lien under the "strong-arm powers" of section 544. The trustee can avoid some statutory liens under section 545. These provisions apply generally to all bankruptcy debtors, regardless of the chapter under which they have filed a petition. The list goes on.

Additionally, in a chapter 11 reorganization plan, a secured creditor can be crammed down and have its lien altered over its objection. If a cramdown happens to a secured creditor, that creditor receives the value of its collateral, not the full amount of its lien. *See* 11 U.S.C. § 1129(b)(2)(A). Similarly, the baseline rule in chapters 12 and 13 is that secured creditors receive only the value of their collateral, 11 U.S.C. §§ 1225(a)(5)(B)(ii), 1325(a)(5)(B)(ii). Where Congress wanted to depart from that baseline rule it wrote specific exceptions. *See* 11 U.S.C. §§ 1322(b)(2), 1325(a) (unnumbered paragraph) (requiring payment of full *allowed* claim, not capped valuation at *allowed secured* claim, for some debts owed on primary residences and new cars). It is also incorrect that a creditor can stand aloof from a bankruptcy proceeding and have its liens survive unscathed. Section 501(c) allows the bankruptcy trustee or the debtor to file a proof of claim on behalf of a creditor who does not file one, lien or no lien.

Thus, the misleading "liens ride through bankruptcy" half-truth invoked in *Dewsnup* and pushed by Bank of America here might be more correctly reformulated as "liens ride through bankruptcy *unless affected by the Bankruptcy Code.*" *Cf. In re Pence*, 905 F.2d 1107, 1109 (7th Cir. 1990) ("These cases actually stand for nothing more than the proposition, now codified in 11 U.S.C. § 506(d), that unless action is taken to avoid a lien, it passes through a bankruptcy proceeding.") Reduced to this proper form, the saying devolves into tautology.

Nonetheless, the tautology provides insight into places where the Code is silent. *Amici* do not dispute the idea that the Code leaves liens in place unless a provision of the statute operates otherwise. In other words, if the Code does not independently adjust the rights of a lienholder, the bankruptcy process leaves those rights untouched. But beyond that general statement of how to treat silence in the Code, the slogan "liens ride through bankruptcy" does not help answer questions such as the one at issue in this appeal. The contest here is precisely whether section 506(d) is one of those many instances where the Code alters liens. Bank of America's misleading incantation that "liens ride through bankruptcy" skips the very analysis that the bank is asking this Court to perform.

B. This Court's Key "Liens Ride Through" Precedent—*Long v. Bullard*—Does Not Actually Hold that Liens Ride Through Bankruptcy

Not only is the naked statement that "liens ride through bankruptcy" misleading on its face, it stems from a misunderstanding of the case usually invoked as the venerable authority for the proposition, *Long v.*

Bullard, 117 U.S. 617 (1886). *See* Pet. Br. 23, 28, 31, and 35. A careful review of the facts of that case clarifies that the primary legal issues involved the interaction between state property law and federal bankruptcy law.

Long, a debtor, had claimed a homestead exemption in his federal bankruptcy proceeding and argued that that exemption defeated a state law mortgage. All this Court held was that claiming the homestead exemption under federal bankruptcy law did not act to eliminate the mortgage on the underlying real estate. *Id.* at 621. The question the Court decided was only whether the debtor's right to claim a homestead exemption in bankruptcy somehow invalidated the lien the creditor claimed as a mortgage. The Court announced no broad principle of liens and bankruptcy law. (Tellingly, the aphoristic phrase appears nowhere in the opinion.) On the contrary, the case was chiefly concerned with federalism and issue preclusion in determining the validity of the mortgage.

Without detouring too deeply into the facts of a 130-year-old case, the main issue in *Long* arose more from the idiosyncratic nature of the mortgage in question than it did from sweeping principles of bankruptcy law. Creditor Bullard loaned money at usurious rates to debtor Long, secured by a deed to Long's house. Long then went through bankruptcy and discharged his debts. When Bullard later came to foreclose on the mortgage, Long successfully challenged Bullard's underlying loan as usurious and therefore invalid under state law, requiring the mortgage to be set aside. Bullard countered that at the time of the original loan, an equitable mortgage arose to the extent the loan was non-usurious. The state courts agreed with Bullard. *Bullard v. Long*, 68 Ga. 821 (1882).

In this Court, the case became one about the ability of the federal courts to revisit state-law determinations regarding when the equitable mortgage arose under state law. Because the state courts had decided the mortgage arose at the time of the original loan, this Court concluded that there was no space for federal courts to say otherwise. As Chief Justice Waite concluded: "*The dispute . was as to the existence of the lien at the time of the commencement of the proceedings in bankruptcy.* That depended entirely on the state laws, as to which the judgment of the state court is final and not subject to review here." *Long*, *117* U.S. at 620-21 (emphasis added). The case was not a solemn pronouncement of the general treatment of liens under federal bankruptcy law, as the subsequent mythology appears to have it. Instead, the parties were litigating the boundary lines between state and federal law in bankruptcy. The Court's conclusion that it was bound to respect state courts' determinations of the existence and timing of state-law property rights had nothing to do with broad principles of bankruptcy.

Long v. Bullard is often associated with the notion that "liens ride through bankruptcy." This is legal mythology. Like the children's game of broken telephone, the idea has been repeated so many times that its original meaning has long been lost. The actual holding of *Long v. Bullard* is much narrower than the half-truth that "liens ride through bankruptcy."

C. Liens Have Always Been Subject to Alteration in Bankruptcy.

Amici for Bank of America include the erroneous recitation of the *Long v. Bullard* mythology. See Brief for Loan Syndications and Trading Association at 12-16

("LSTA Brief"). But those *amici* seem to make another historical argument: independent of *Long*, the principle that liens cannot be violated in bankruptcy has been a constant principle of federal bankruptcy law.

This is incorrect. There are of course cases holding that particular facts do not trigger lien-avoiding provisions of the Code. Again, *amici* here agree with *amici* for Bank of America that the bankruptcy discharge does not, without more, erase an otherwise legal lien. LSTA Brief at 12, 16. The extensive history cited in the LSTA Brief demonstrates precisely this view that all parties can endorse. Liens *sometimes* survive bankruptcy, except when they do not.

But this proposition is obvious and unhelpful. Despite the historical examples offered by LSTA, previous versions of the bankruptcy law routinely allowed courts to avoid liens for reasons "other than payment on the debt." *Dewsnup*, 502 U.S. at 418-19. For example, section 14 of the Bankruptcy Act of 1867 allowed the avoidance of any judicial lien obtained within four months of the bankruptcy. Bankruptcy Act of Mar. 2, 1867, ch. 176, 14 Stat. 517 § 14 (repealed 1878) ("1867 Act"). Section 67 of the Bankruptcy Act of 1898 did much the same thing. Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544, § 67 (repealed 1978). Under these laws, creditors who obtained liens as an impermissible preference did not survive bankruptcy. Similarly, liens that were obtained for less than reasonably equivalent value have been avoidable as fraudulent transfers. *See, e.g., id.*

The most that can be said regarding the historical practice of liens in bankruptcy under prior statutes was that provisions expressly protecting liens were included in the Bankruptcy Acts of 1800 and 1841. And the

Bankruptcy Act of 1867 allowed for protection outside the four-month window mentioned above. *See* Bankruptcy Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 § 63 (repealed 1803); Bankruptcy Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 § 2 (repealed 1843); 1867 Act § 14. To that limited extent, then, it is true that some liens under some prior versions of the federal bankruptcy law "rode through" bankruptcy by explicit congressional command. But at that level of generality, the proposition is unremarkable.

D. Whether Liens Sometimes Rode Through Bankruptcy Is Ultimately Irrelevant

All this historical discussion reduces to two general points: (1) liens sometimes rode through bankruptcy under prior, repealed versions of the bankruptcy laws, and (2) sometimes they did not under those same laws. But it is a strange argument to insist that 200-year-old statutes, since abrogated in their entirety by an intentionally comprehensive overhaul of the bankruptcy system, should count as anything other than a historical curiosity.

To decide whether Congress's innovations to the rights of secured creditors were intentional or inadvertent in 1978 should require focus on what *that* Congress, not prior Congresses, said. And there, the House Judiciary Committee's report explained the reasons for the changes in section 506, and is worth quoting in full.

> One of the more significant changes [wrought by the Bankruptcy Code] is the treatment of secured creditors and secured claims. The distinction becomes important in the handling of

> creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors who are undersecured.
>
> . . . .
>
> Throughout the bill, references to secured claims are only to the claim determined to be secured [under Section 506(a)], and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their place "secured claim" and "unsecured claim."

H.R. Rep. No. 95-595, at 180-81, 356.

The opinion in *Dewsnup* mistakenly contends there is no evidence in the "annals of Congress," 502 U.S. at 420, that section 506 was meant to deviate from the opinion's understanding of bankruptcy history. But the opinion did not cite that history, even as other, pre-*Dewsnup* circuit courts had done. *See In re Lewis*, 875 F 2d 53, 55 (3d Cir. 1989); *In re Ahlers*, 794 F 2d 388, 394 n.5 (8th Cir. 1986), *rev'd on other grounds*, 485 U.S. 197 (1988). The existence of the committee report's clear explanation of congressional intent behind section 506 further undercuts *Dewsnup*'s claim that Congress was inadvertently abrogating a historical practice of lien protection in bankruptcy law.[5]

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[5] *Amici* appreciate that the Court believed the historical bankruptcy practice illuminating in *Dewsnup*, 502 U.S. at 418-19, but the brief discussion there (relied upon heavily by Bank of America) oversimplified the history. As just discussed, provisions of pre-Code law frequently invalidated liens for reasons other than payment. *But see id.* ("Apart from reorganization proceedings, *see*

(Continued...)

IV. This Court Should Overrule *Dewsnup*

Amici believe that *Dewsnup* need not be overruled to affirm the judgment below. In *Dewsnup*, the lien in question still had market value: it was merely worth less than the debt owed on the lien. At least in those factual circumstances, an undersecured creditor retains the incentive to reach out-of-bankruptcy settlement. But, as argued above, liens such as Bank of America's that retain no market value give the holder no incentive to do anything but impede the orderly resolution of a homeowner's financial distress. Thus, *amici* urge the Court to uphold the lower court's decision.

A cleaner way, however, for the Court to reach the same result would be to overrule *Dewsnup* once and for all and return the plain meaning to the text of section 506(d) that *Dewsnup* upended. Whether this case presents the best vehicle to do so is something on which *amici* express no opinion. *Amici* are certain, though, that the opinion is deeply flawed and should be abandoned.

Dewsnup is a short and thinly-theorized precedent that almost no bankruptcy scholar defends. The principal problem is one of statutory interpretation. The opinion is almost completely irreconcilable with the plain language of the Code and effectively concedes as much.

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11 U.S.C. §§ 616(1) and (10) (1976 ed.), no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt."). And, *Long v. Bullard* was about much more than the bankruptcy discharge's effect on liens. *But see id.* at 419 ("In *Long v. Bullard*, 117 U.S. 617, 620–621 (1886), the Court held that a discharge in bankruptcy does not release real estate of the debtor from the lien of a mortgage created by him before the bankruptcy.").

Id. at 417 ("Were we writing on a clean slate, we might be inclined to agree with petitioner that the words 'allowed secured claim' must take the same meaning in §506(d) as in § 506(a)"). This tension has led to the widespread—near-unanimous—criticism of that opinion by bankruptcy scholars. *See, e.g.*, David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 Am. Bankr. L.J. 1, 16 (1996) (characterizing *Dewsnup*'s assignment of different meanings to "allowed secured claim" in §§506(a) and (d) as "overt interpretive violence"); Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 Mich. L. Rev. 2234 (1997) ("*Dewsnup* was not only a historical anomaly in terms of the Supreme Court's established methodology in its approach to bankruptcy cases, but also an untenable exception in the ever-more-clearly emerging course of bankruptcy jurisprudence under the Code.").

As a matter of textual interpretation, *Dewsnup* could most charitably be described as problematic. Section 506(d) provides, in relevant part, that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). The Court in *Dewsnup* read "allowed secured claim"—an expressly defined term of art in the Code—to mean "allowed claim." *Dewsnup*, 502 U.S. at 417–18.[6]

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[6] *Dewsnup* attempted to redefine "allowed secured claim" in section 506(d) as, effectively, "allowed claim that is at least in some part secured." An undersecured creditor's full allowed claim would thus meet this definition, as it is both allowed and, to some extent, secured.

(Continued...)

By so doing, the Court excised one of the most important words in the Code from this section. In bankruptcy, most everything hangs on whether a creditor holds (or does not hold) a security interest. It is one thing to read the same term in different parts of a lengthy statute differently. It is quite another to do so *within the very same statutory section in which it is defined*, as Justices Scalia and Souter forcefully observed in dissent. *See Dewsnap*, 502 U.S. at 422 (Scalia, J., dissenting) (observing the rule that identical words used in different parts of the same statute take the same meaning "must surely apply, *a fortiori*, to use of identical words *in the same section of the same enactment.*")

Dewsnup's error is not confined to section 506(d). Rather, it destabilizes section 506(a)'s definition of "allowed secured claim" in a way that casts doubt on the vitality of its meaning. It is supposed to be a "term of art," *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993), that is used "throughout the Code," H.R. Rep. No. 95-595 at 356. *Dewsnup*'s rewriting of "allowed secured claim" in one part of the Code means its

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The problem with this special reading of "allowed secured claim" is that section 506(d) is a provision that specifically voids liens. Voiding liens can only apply to secured claims, because there is no such thing as a lien on an unsecured claim. By definition, an unsecured claim is a debt *unsecured by a lien*.

Dewsnup's reading of section 506(d) to restrict lien avoidance on liens that satisfy its two prongs—(1) allowed, and (2) to some extent, secured—thus contains a redundant second prong, which means the test collapses into the first prong only: liens are not avoided on allowed claims. Thus, *Dewsnup* presents a textual conundrum of reading "allowed secured claim" as "allowed claim," a concession Bank of America is forced to make. Pet. Br. at 19.

meaning in other sections is up for grabs for lenders and debtors to litigate and bankruptcy, district, and appellate courts to redefine with no burden of consistency. Such uncertainty and inconsistency are anathema to the spirit and letter of uniformity that Congress wrought in the passage of the Code for the hundreds of thousands of bankruptcy petitions adjudicated annually. "The risks of relying on such practice in interpreting the Bankruptcy Code, which seeks to bring an entire area of law under a single, coherent statutory umbrella, are especially weighty." *Bank of America National Trust & Sav. Ass'n v. 203 North LaSalle Street P'ship*, 526 U.S. 434, 461 (1999) (Thomas, J., concurring).

Dewsnup has been subsequently criticized by members of the Court as committing "methodological error" in laying the grounds for this uncertainty. *Id.* at 461; *see also id.* at 463 ("Regrettably, subsequent decisions in the lower courts have borne out the dissenters' fears. The methodological confusion created by *Dewsnup* has enshrouded both the Courts of Appeals and, even more tellingly, Bankruptcy Courts, which must interpret the Code on a daily basis.") This uncertainty lingers over the Code today and will continue to do so until this Court abandons *Dewsnup*'s faulty reasoning.

Amici are mindful of the doctrine of *stare decisis*, and do not seek to portray themselves as experts thereon. Whether this is the right vehicle to overrule *Dewsnup*, or whether an overruling should be given only prospective effect to future creditors, are questions that

likely exceed our areas of expertise.[7] *Amici* note nothing more than the fact that this Court can and does overrule statutory precedents when appropriate circumstances arise. *See, e.g., Hubbard v. United States*, 514 U.S. 695 (1995) (overturning previous statutory interpretation and returning to the plain textual meaning). To the extent helpful to the Court's analysis, *amici* advise from their perspective as bankruptcy experts that the *Dewsnup* opinion is uniformly criticized, generally wreaks havoc with the Code by injecting unwarranted uncertainty, and is unlikely to have generated any serious reliance interests by secured creditors according to the best available empirical evidence.

* * *

Bank of America and other underwater junior lienholders charge higher interest rates for their risky investments. But they are not completely without recourse in the event that their risky security becomes worthless: the bankruptcy process allows them to participate in the valuation of the property and, if necessary, share in the estate as unsecured creditors.

What the bank now seeks, though, is something else, something new: hostage value that will disrupt the bankruptcy process and wreak havoc on debtors and

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[7] There is only one *stare decisis* point *amici* wish to address specifically. Bank of America contends congressional inaction demonstrates acquiescence to *Dewsnup*. Pet. Br. 41. *Amici* think this is unfair. Because the Court itself admitted it was contravening the fairest reading of the text of section 506(d), it's not clear how Congress should have amended that text, other than adding "i.e., as just defined in subsection (a)," right after "allowed secured claim," which would be a startling drafting requirement.

creditors alike. The Court should reject Bank of America's breathtaking suggestion that hostage value is a central and time-honored policy of the Code. Reversing the lower court would create an asset that gives comfort only to those creditors who seek to shake down debtors and senior creditors for a payment that neither the market nor the Code would permit. This Court should not play along with Bank of America's attempt to enjoy a leg up over other creditors and get a risk-free investment at the expense of the bankruptcy process.

CONCLUSION

For the foregoing reasons, the decision of the court of appeals should be affirmed.

Respectfully submitted,

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Petitioner,

—v.—

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

—v.—

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR *AMICI CURIAE* PROFESSORS JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, LINDA COCO, JESSICA DAWN GABEL, KENNETH N. KLEE, GEORGE W. KUNEY, LOIS R. LUPICA, LAWRENCE PONOROFF, C. SCOTT PRYOR, NANCY B. RAPOPORT, MARIE T. REILLY, KEITH SHARFMAN, AND MICHAEL SOUSA IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI*[1]

The *amici*[2] are a group of law professors who have devoted their careers to the study and teaching of bankruptcy law. Their interest is to encourage the Court to apply the Bankruptcy Code (the "Code")[3] in light of its overall structure and to read its provisions consistently, thereby providing predictability for future cases. The *amici* are keenly interested in this appeal because the outcome of the issue before the Court will have an impact on an enormous number of business and

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[1] Pursuant to Rule 37 of the Rules of this Court, the *amici* file this brief with the written consent of both parties, which are on file with the Clerk. No person or entity including the *amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *amici* are the following law professors who teach at the law schools indicated next to their names: *Jagdeep S. Bhandari*, Florida Coastal College of Law; *Susan Block-Lieb*, Fordham University School of Law; *Linda Coco*, Barry University School of Law; *Jessica Dawn Gabel*, Georgia State University College of Law; *Kenneth N. Klee*, UCLA School of Law; *George W. Kuney*, University of Tennessee College of Law; *Lois R. Lupica*, University of Maine School of Law; *Lawrence Ponoroff*, University of Arizona James E. Rogers College of Law; *C. Scott Pryor*, Regent University School of Law; *Nancy B. Rapoport*, University of Nevada William S. Boyd School of Law; *Marie T. Reilly*, Penn State University Dickenson School of Law; *Keith Sharfman*, St. John's University School of Law; and *Michael Sousa*, University of Denver Sturm College of Law. The positions taken in this brief are theirs alone and may not be attributed to their law schools or any law firms with which they are affiliated or clients whom they represent in unrelated matters.

[3] All references in this brief to numbered sections are to the Bankruptcy Code, 11 U.S.C.

individual debtors seeking a fresh start under chapter 7 of the Code. Chapter 7 debtors often hold property, including their homes, subject to a first mortgage and sometimes also subject to a valueless junior mortgage. The *amici* believe that the correct view of section 506(d) of the Code is that it provides for stripping off a wholly valueless junior mortgage in a chapter 7 case, thereby furthering the debtor's opportunity for a fresh start.

SUMMARY OF ARGUMENT

When the collateral for a claim secured by a second mortgage lacks sufficient value to provide full payment of the first mortgage claim, it should not be treated as an "allowed secured claim" under section 506(d) of the Code. This is because such a claim constitutes an unsecured claim, not a secured claim under the clear definitions of "secured claim" and "unsecured claim" in section 506(a) of the Code. This reading of the Code is supported by a pre-Code practice under which valueless junior mortgages were stripped off.

Decades before the enactment of the Code, this Court's jurisprudence regarding the treatment of junior secured creditors in bankruptcy cases established that their rights were limited to the value of the collateral securing their claims. This was the established practice in reorganization cases, under which valueless junior mortgages were terminated, in recognition of the fact that they had no value that needed protection.

During the pre-Code era, the cases before this Court in which liens passed through bankruptcy

involved first mortgage liens, whereas in several other cases addressed by this Court it held that worthless junior mortgage liens should be treated as unsecured claims. As held in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 278 (1940) (herein "*Union Central*"), a junior mortgage is entitled to protection only to the extent of the value of the collateral. However, *Dewsnup v. Timm*, 502 U.S. 410 (1992) (herein "*Dewsnup*"), in addressing the treatment of a first mortgage, relied on the pre-Code case law under which first mortgages backed by some collateral value could survive a bankruptcy. Notably, *Dewsnup* lacks any discussion of this Court's carefully developed pre-Code jurisprudence authorizing the stripoff of valueless second mortgages. *See In re 620 Church Street Bldg. Corp.*, 299 U.S. 24 (1936) (herein "*Church Street*"); *Ecker v. Western Pac. R. R. Corp.*, 318 U.S. 448 (1943) (herein "*Ecker*").

A half-century later, this Court, in *Dewsnup*, addressed the treatment under the Code of a partially secured first mortgage. In holding that a first mortgage could not be stripped down under section 506(d), the Court did not address whether a valueless second mortgage could be stripped off and did not cite this Court's groundbreaking pre-Code decisions under which valueless second mortgages were stripped off. In *Dewsnup*, this Court held that when a claim's collateral covered 32.5% of the first mortgage debt, the mortgage could not be stripped down to its value under section 506(d) in a chapter 7 case. The Court, however, candidly acknowledged that it was inclined to rule otherwise and to read "allowed secured claim" in section 506(d) in accordance with section 506(a). The Court also carefully

limited its holding to the "strip down" issue posed where a mortgage is backed by some collateral value, stating that its resolution of the issue posed by "other facts" would "await their resolution on another day." *Id.* at 416–17. This Court is presented with an opportunity to consider in this case "other facts" that give rise to whether its theory in *Dewsnup* should be applied in resolving the treatment of a valueless second mortgage under section 506(d). The *amici* submit that the Court's analysis in *Dewsnup* for rejecting strip downs of partially secured first mortgages does not apply to require the survival after bankruptcy of a valueless second mortgage.

In construing the text of section 506 as ambiguous, the Court in *Dewsnup* relied on what it said was "the pre-Code rule that liens pass through bankruptcy unaffected." *Dewnsup*, 502 U.S. at 417. However, this Court's pre-Code jurisprudence on the treatment of mortgages in bankruptcy cases makes clear that liens did not always pass through bankruptcy unaffected, and indeed that valueless mortgages were stripped off under a bankruptcy statute. Although the Court's jurisprudence allowing the stripoff of valueless second mortgages developed in reorganization cases, the Court's underlying theory was based on the valuelessness of the mortgaged property, not because the case sought reorganization. The Court's stripoff theory is no less applicable in a chapter 7 case than in cases under other chapters of the Code, although section 1123(a)(5)(E) expressly authorizes the modification of liens under a chapter 11 reorganization plan.

The Court in *Dewsnup* also relied on *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555

(1935) (herein "*Radford*"), without citation to the important opinions of this Court that followed closely after *Radford* during the 1930s and 1940s. As the *amici* show, *Union Central*, *Church Street*, and *Ecker* negated *Radford*. These later decisions rejected *Radford*'s focus on the property rights of a first mortgage holder, and its original contract bargain, and instead were informed by a debtor's entitlement to a fresh start implemented by the discharge provision of the bankruptcy law. The Court in *Dewsnup* also relied on *Long v. Bullard*, 117 U.S. 617 (1886) (herein "*Long*"), which held that a debtor's discharge in bankruptcy only discharged his personal liability for the mortgage debt, but did not discharge the mortgage itself. *Long*, however, did not establish a principle or rule of law that a mortgage could not be voided for a reason *other than* the discharge. Indeed, *Long* never stated that liens pass through bankruptcy unaffected. Although that case did not establish that there was a practice for liens to pass through bankruptcy unaffected, later cases misread it for that principle, without examining the pre-Code decisions of this Court under which junior mortgages were voided.

The *amici* urge this Court to apply its early decisions allowing liens to be stripped off as the basis for reading section 506(d) as authorizing the voiding of a valueless second mortgage. Furthermore, under the Code as enacted in 1978, liens clearly do not pass through bankruptcy unaffected. Contrary to petitioner's contention, no mandate can be found in the Code for liens to pass through bankruptcy unaffected, which is underscored by the numerous provisions of the Code under which liens are modified or even

removed. Indeed, such other provisions provide for affecting mortgages in various ways, without regard to whether the collateral has value to cover the debt. Section 506 was written to deal with the very situation in which liens are undersecured or wholly unsecured and are not covered by these other lien-affecting provisions. Section 506(a), as a part of the overall structure of the Code in regard to the treatment of liens, establishes for purposes of other Code provisions, including section 506(d), that a claim secured by a lien on property is a "secured claim" only to the extent of the value of the property.

Moreover, petitioner's contention that 506(d) exists solely to void secured claims that are disallowed under section 502, is facially erroneous. Reading 506(d) in such a manner would render it supefluous, because by operation of law a lien is *already* void if the underlying claim is unenforceable. This Court is loath to read a statute in such a manner.

The Code's "limited to value" theory is strongly supported by the fresh start objective of its discharge provision. A debtor's fresh start should not be impaired by treating a valueless mortgage as if it has value. A discha ge is designed to free honest debtors from their dischargeable unsecured debt so as to give them an opportunity for a fresh start. Many holders of first mortgages enter into post-bankruptcy agreements revising their claims providing, among other arrangements, for deferred payments or reducing the amount of the claim. There is good reason to encourage the making of such agreements. They enhance the debtor's opportunity for a fresh start by enabling

the debtor to retain his or her property. They also benefit first mortgagees because such agreements offer them a chance to effect a larger recovery than otherwise, and to avoid the cost, delay, and uncertainty of a mortgage foreclosure proceeding. However, such a post-bankruptcy agreement cannot be effectuated without the consent of the second mortgage holder. This is good reason to allow the stripoff of a valueless second mortgage. The denial of a right to strip off a wholly underwater second mortgage would only serve to allow its holder, until it could extract some payment on its valueless mortgage, to stand in the way of a new agreement between the debtor and the first mortgagee revising the mortgage debt.

Petitioner's *amici* do not offer a cogent economic basis for precluding stripoffs of valueless junior mortgages. The *amicus* brief of its *amici*, Loan Syndications and Trading Association, *et al.* (herein together, "LSTA") opposes allowing stripoffs. It relies primarily on a short article in a periodical, which states that there is a demand by private equity investment firms for junior mortgages because "[i]n today's yield-starved landscape, second-lien loans are an oasis of relatively high margins." LSTA's *amicus* brief at 6 n. 4 (citing Forbes.com article, March 14, 2014). The interest of the LSTA *amici* in the investment opportunities and large profits for their constituencies is understandable, but does not demonstrate that allowing stripoffs in chapter 7 cases will produce the dire consequences they suggest will result. Indeed, the United States, which filed an *amicus* brief in *Dewsnup* because of its keen interest in *first* mortgages, chose *not* to file an *amicus* brief in this case. The silence of the

United States in this case suggests that the concern of petitioner's *amici* with allowing the stripoff of valueless junior mortgages is unwarranted. The concerns of LSTA and their constituencies should be directed to the Congress, not this Court.

ARGUMENT

POINT I

UNDER THIS COURT'S PRE-CODE JURISPRUDENCE, A MORTGAGE THAT HAS NO UNDERLYING COLLATERAL VALUE MAY BE STRIPPED OFF AND THEREBY ELIMINATED

A. *DEWSNUP* DOES NOT PRECLUDE THE STRIP-OFF OF A VALUELESS JUNIOR MORTGAGE

There was a pre-Code practice under which wholly underwater junior mortgages were stripped off in bankruptcy. This practice implemented this Court's pre-Code jurisprudence that developed under reorganization statutes enacted by Congress in the 1930s. As analyzed by the Court, a wholly underwater junior mortgage had no value, and thus needed no protection. The Court's theory was based on the valuelessness of such a mortgage, not because the question as to the treatment of a secured claim arose under a reorganization statute. The Court's jurisprudence applies equally in a bankruptcy case for liquidation. A valueless junior mortgage does not gain value because the question of its treatment arises in a liquidation case, or lacks value only when addressed in a reorganization case. A valueless junior mortgage should thus be subject to a stripoff in any case under the bankruptcy law.

There is a difference between a valueless second mortgage and a first mortgage backed by at least some value. It is most unusual for the foreclosure of a mortgage to yield proceeds in an amount sufficient to cover even the entire amount of the first mortgage on the property. Second mortgages are generally just out of the money. This Court's decision in *Dewsnup* should be understood in that light. In *Dewsnup*, the mortgagee's claim of approximately $120,000 was backed by mortgaged property valued by the court at $39,000, or only 32.5% of the debt. *See Dewsnup*, 502 U.S. at 413. *Dewsnup* addressed a partially secured claim. The treatment of a wholly unsecured claim was not before the Court, and its opinion neither reached that issue nor addressed it. This issue is among those left by the Court in *Dewsnup* for resolution on another day. *See Id.* at 417.

Although *Dewsnup* poses a very different issue than is presented by this case, petitioner and its *amici*, LSTA, rely on *Dewsnup*'s approach to the treatment of first mortgages backed by collateral as dispositive of this case. They mistakenly urge that *Dewsnup* applies because of a claimed pre-Code practice for liens to pass through bankruptcy unaffected. That assertion is wrong on its face because of the pre-Code practice under which wholly underwater second mortgages were extinguished and thus did not pass through bankruptcy at all. *Dewsnup*'s recognition of the pre-Code practice should be limited to the treatment of first mortgages, which may have often survived bankruptcy. Moreover, petitioner and its *amici* also mistakenly assert this Court's 1935 decision in *Radford* as controlling precedent. *Radford*, like *Dewsnup*, did not address the

treatment of a valueless mortgage. More importantly, *Radford*'s statement that a mortgagee could "insist upon full payment before giving up his security," 295 U.S. at 580, was *dictum*, and *Radford* was itself negated by a series of decisions of this Court rendered shortly thereafter. *See* Point I.B *infra*.

B. This Court's Well Settled Pre-Code Jurisprudence Allows Stripping Off Wholly Underwater Junior Mortgages

Beginning in the 1930s, this Court heard several bankruptcy appeals involving the rights of secured creditors whose collateral under junior mortgages was secured by property whose value was not sufficient even to cover the senior mortgage on the property. Under the Court's jurisprudence developed in several ground-breaking opinions, a junior mortgagee's rights were held to be limited to the value of the collateral, as determined by the court in the bankruptcy case. *See, e.g., Church Street*, 299 U.S. at 27. When the value of the property was insufficient even to pay the amount of a first mortgage on the property. this Court squarely held that a junior mortgage, lacking any collateral value, could be stripped off entirely and thereby eliminated. A valueless mortgage claim was thus treated for what it was, namely an unsecured claim. *See, e.g., Ecker*. 318 U.S. at 475–76.

By contrast, under *Radford*, decided in 1935 before this Court formulated its jurisprudence based on the value of a lien, first mortgage liens were viewed as enforceable after bankruptcy based on the amount due. Significantly, however, *Radford*'s earlier "full payment" view was *negated*

by several decisions of this Court that limited the rights of the creditor under a mortgage to the value of the property as determined by the court in the bankruptcy case. The *amici* urge that the Court should read section 506 in light of its pre-Code decisions, and that there is no basis for the Court to resurrect *Radford*'s discarded view that a mortgage cannot be terminated except by payment in full, particularly where, as here, the lien at issue is a wholly underwater junior mortgage.

The first of these groundbreaking decisions was *Church Street*, decided in 1936. The Court held that because the subject property was worth only 55% of the amount due on a first mortgage claim, a second mortgage had no collateral value to protect it, and the holders thus had no right to receive any distribution on their claims in a reorganization under section 77B of the former Bankruptcy Act. *See Church Street*, 299 U.S. at 27. As analyzed by this Court: "Here the controlling finding is not only that there was no equity in the property above the first mortgage, but that petitioners' claims were appraised by the court as having 'no value.' There was no value to be protected." *Id.*

Four years later, in *Union Central*, a case applying section 75, subs.(3) of the Bankruptcy Act as enacted in 1935, this Court held that the rights of a secured party were limited to the value of the collateral. *See Union Central*, 311 U.S. at 278. In that case the Act contained conflicting provisions. Under one provision, the debtor elected to redeem the subject property from a mortgage in the amount of $15,903.68 for the $6,000 value found by the bankruptcy court, and asserted its right to be discharged from an

obligation to pay the unpaid balance of the debt. *See Id.* at 276. After the debtor attempted to exercise this right, the mortgagee asserted another provision of the Act, which granted the mortgagee a right to compel a public sale of the property. *See Id.* at 276–77. In reconciling this statutory inconsistency, this Court ruled that the debtor's right to purchase prevailed, observing that the Act was intended to protect distressed debtors—in that case farmers—"faced with the disaster of forced sales and an oppressive burden of debt." *Id.* at 278. Specifically, the Court held that the debtor had the right to purchase the property at its value as determined by the court, observing that "[t]here is no constitutional claim of the creditor to more than that." *Id.* This result was reached even though the Act afforded a debtor three years to decide whether to elect to purchase the property, because during this period the rights of the creditor were protected "to the extent of the value of the property." *Id.* Rejecting "narrow formalistic interpretations which disregard the spirit and the letter of the Act," the Court held that the debtor was entitled to have the value of the property fixed by the court and to redeem at that value. *Id.* at 279, 281. To deny the debtor's right to redeem at the value fixed by the court "would be to rewrite the Act." *Id.* at 281.

Union Central was soon followed by this Court's decision in *Ecker*, which, relying on *Church Street*, held that the claims of creditors holding junior mortgages could be written off because the entire value of the properties had been exhausted by senior mortgages and thus were valueless. *Ecker*, 318 U.S. at 475–76. In so holding, the Court stated that the mere possibility that the property might

have increased earning power in the future did not require that the junior mortgagees be provided with an equity security by means of which they could share in a possible future increase in value. *See Id.* at 476. As stated in the leading treatise on pre-Code bankruptcy law, an underwater mortgage may be "appraised out, [i.e. stripped off] because a forced sale would leave nothing for it, even though there may be value behind the junior claims on a going concern basis." 5 *Collier on Bankruptcy*, ¶ 77.17, p. 583 (14th ed. 1978, first published in 1943) (citing *Church Street* and *Ecker*).

C. PETITIONER'S AND ITS *AMICI*'S POSITION IS NOT SUPPORTED BY *RADFORD*

Union Central, *Ecker*, and *Church Street* represent an important part of this Court's jurisprudence regarding the treatment of liens under the bankruptcy law. Indeed, in light of these decisions, it should not have been a surprise that section 506 was written to incorporate the well-established pre-Code doctrine under which valueless junior mortgages were stripped off. Despite the holdings of these cases, petitioner and its *amici* do not discuss or even cite the decisions in *Union Central*, *Ecker* and *Church Street*. Instead, they urge the Court to rely on the *dictum* in its earlier 1935 decision in *Radford*. Unlike its subsequent decisions that stripped off wholly underwater junior mortgages, *Radford* expressed the view that a mortgagee was entitled to the benefit of its bargain with the debtor, stating: "The right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage." 295 U.S. at 580. *Radford*'s view, however, in addition to

having been later negated, was merely *dictum*. The Court's holding was that the retroactive application of the statute at issue to pre-existing mortgages violated the Fifth Amendment's prohibition against impairing the obligations of contracts. *See Id.* at 589. In not perpetuating *Radford*'s *dictum*, this Court rejected *Radford*'s view that a mortgage continues to exist until full payment of the debt it secures and may be foreclosed, instead recognizing the reality that a wholly underwater junior mortgage is an unsecured claim.

Indeed, *Union Central* represents the antithesis of the position taken by the United States in its *amicus* brief filed in *Dewsnup*, upon which the Court relied in that case. There, the United States cited *Radford* as "[t]he best illustration of the clear understanding of the inviolability of liens in bankruptcy proceedings." United States' *Amicus* Br. for Resp. at 26. By sharp contrast, in an earlier decision in the *Union Central* case, this Court stated that "[p]roperty rights do *not* gain any absolute inviolability in the bankruptcy court because [they are] created and protected by state law." *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 517 (1938) (emphasis added). Indeed, the Court made clear that Congress "may authorize the bankruptcy court to affect [state law] property rights, provided the limitations of the due process clause are observed." *Id.* Reliance by petitioner and its *amici* on *Radford* as demonstrative of a pre-Code "payment in full" entitlement of secured creditors missed the mark.

Invoking *Dewsnup*, LSTA's amicus brief misstates pre-Code bankruptcy law by stating that nothing in the old Acts empowered courts "to

compel a lienholder—holding a senior lien or a junior lien, regardless of the collateral's value—to release its collateral to the debtor while its loan remained unpaid." LSTA's *amicus* brief at 9. In an attempt to support that position, they too rely on *Radford*. *See Id.* ("this Court promptly invalidated the only statute that purported to grant that power.") (citing *Radford*, 295 U.S. at 581–82). The petitioner itself relies on *Radford* in the same improper manner: "the 'right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage' throughout the history of bankruptcy law." Pet. Br. at 23 (citing *Radford*, 295 U.S. at 580). Particularly, petitioners rely on *Radford*, arguing that "before the enactment of the Bankruptcy Code it was settled law that liens passed through liquidation proceedings unaffected, regardless of the value of the collateral securing them." Pet. Br. at 30 (citing *Dewsnup*, 502 U.S. at 418; *Radford*, 295 U.S. at 579).

Even though *Union Central* negated *Radford*'s rule that a creditor is entitled to full satisfaction of its debt before its mortgage may be affected, nowhere in petitioner's account of pre-Code history is *Union Central* mentioned. Likewise, *Union Central* is absent from petitioner's *amici*'s discussion of "the treatment of liens under the various federal bankruptcy statutes that predated" the Code. LSTA's *amicus* brief at 8. *Dewsnup* also did not cite *Union Central*.This omission may be explained by the fact that the treatment of valueless liens was not before the Court in *Dewsnup*, and because the Court there relied on *Radford*, which involved a *primary*

mortgage that was supported by substantial value.

The *amici* urge the Court not to rely on *Radford*'s negated *dictum*, particularly in this case involving a junior mortgage that is completely underwater, unlike the senior mortgage in *Radford* that was backed by substantial collateral value. Indeed, the Court should read section 506 as it was written, just as this Court read the earlier bankruptcy acts in its major pre-Code opinions that superseded *Radford*. The petitioner and its *amici* offer no plausible reason for calling on the Court to rehabilitate *Radford* and to reject the established pre-Code practice allowing wholly underwater mortgages to be stripped off.

D. *Long v. Bullard* Did Not Establish a Principle that Liens Pass Through Bankruptcy Unaffected

The *amici* urge that *Long v. Bullard*, upon which petitioner and its *amici* also rely heavily, does not, as claimed by petitioner and its *amici*, establish a general principle that liens pass through bankruptcy unaffected. Although some more recent cases have relied on *Long* for that principle, *Long* did not so hold and did not articulate that principle. In *Long*, a creditor loaned money to the debtor, a portion of the proceeds of which were "used to pay off the incumbrance on the homestead." 117 U.S. at 619. With the payoff of the existing mortgage, the mortgage received by the creditor as security for the loan became a first mortgage. *Long* did not involve and did not address the treatment of a valueless junior mortgage under the bankruptcy

law. The issue before the Court was "the effect of the discharge in bankruptcy upon the right of [a creditor] to enforce a lien upon the property in existence at the time of the commencement of the proceedings in bankruptcy." *Id.* at 620. Holding that the discharge did not release the lien, the Court deemed a state foreclosure proceeding proper. *See Id.* at 621. *Long* stands for the proposition that a bankruptcy *discharge* does not affect a lien that is valid under state law. *See Id.* In fact, applying the Court's holding in *Long* to situations involving underwater junior liens is especially improper, considering *Long*'s limited scope. *Long* did not hold or say that a mortgage could not be voided for a reason *other than* a discharge, for example because of the valuelessness of a mortgage. Expanding *Long*'s holding beyond its boundary not only misstates the case, but also inaccurately depicts the pre-Code jurisprudence of this Court regarding the treatment of valueless junior liens.

The *amici* urge that *Long* does not preclude the stripoff of a valueless junior mortgage. Although some much more recent cases view *Long* as pronouncing a broad rule that, by virtue of the pre-Code bankruptcy law, a mortgage survives bankruptcy unaffected, that statement is incorrect in light of the established pre-Code practice to write off valueless junior mortgages. As held by *Long*, the *discharge* of the debtor "did not relieve the property from the operation of liens created by contract before the bankruptcy." *Id.* at 621. The Court's decision, moreover, did not explain how liens operate in all circumstances, having only considered how a first mortgage operated where, as in *Long*, the mortgage appeared to have been a

fully secured first mortgage. *Long's* holding that a bankruptcy discharge does not *by itself* operate to prevent the enforcement of a mortgage, is far more limited than the broad meaning attributed to it, to the effect that the bankruptcy law's protection of a lien from the operation of a discharge precludes the termination of a lien under a provision of the bankruptcy law. Such provisions were sustained and applied under this Court's pre-Code jurisprudence, and section 506 should likewise be read and applied just as Congress wrote it.

Petitioner's *amicus*, LSTA, misunderstanding the text and purpose of section 67d of the Bankruptcy Act of 1898, also mistakenly argues that former section 67d operated to preserve liens after bankruptcy. *See* LSTA's *amicus* brief p. 15. Former section 67d, which was succeeded by the fraudulent conveyance provisions of section 548 of the Code, clearly stated that a lien would not be affected by the 1898 Act only if the lien was created in good faith, for a present consideration, and "not in fraud under this Act." Section 67d had nothing whatever to do with undersecured or wholly unsecured mortgages. Moreover, *City of Richmond v. Bird*, 249 U.S. 174 (1919), was misleadingly cited by LSTA in support of its section 67d argument. There was no claim in that case that the lien in question was fraudulently obtained, this Court having also stated: "It is not denied that respondents obtained a present valid lien upon the bankrupt's goods . . . ; nor is it now claimed this was annulled by adjudication of bankruptcy." *Id.* at 175.

Petitioner's LSTA *amici*, in urging that the bankruptcy law bars the stripoff of a mortgage, also misunderstand the limited effect of a

bankruptcy discharge on a mortgage, as explained in the first edition of Collier quoted by LSTA at page 17 of their brief. There, Collier merely stated that if mortgages are valid under state law and not rendered void by a bankruptcy act, "the bankrupt's discharge will not prevent their enforcement." There is no basis for subsequent cases to transform that narrow statement into a global proposition that reads the bankruptcy discharge as immunizing mortgages from termination in accordance with a bankruptcy law provision.

When Congress amends the bankruptcy laws, it is "not writing on a clean slate." *Emil v. Hanley*, 318 U.S. 515, 521 (1943). Congress was presumably aware of the pre-Code practice of stripping off wholly underwater junior liens. The Code should thus be understood and read in light of that pre-Code practice implementing this Court's pre-Code jurisprudence.

POINT II

SECTION 506(d) REFLECTS THIS COURT'S JURISPRUDENCE UNDER WHICH A VALUELESS JUNIOR MORTGAGE MAY BE STRIPPED OFF

A. Just As Congress Provided for Stripping Off Junior Mortgages in Reorganization Cases in the Pre-Code Era, It Did So in Section 506(d)

1. The Bankruptcy Code only protects liens to the extent of the collateral's value

Under the plain language of section 506(a), a claim secured by a lien is protected only to the extent of the value of the collateral. The clear

import of section 506(a), a part of the Code section entitled "Determination of secured status," is to bifurcate allowed claims into secured and unsecured portions. Under section 506(a), a claim is secured only to the extent of the value of the property securing the claim. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989) (stating "a claim is secured only to the extent of the value of the property on which the lien is fixed."). This portion of the claim, secured up to the value of the collateral, is referred to throughout the Code as an "allowed secured claim." *See, e.g., Harmon v. United States through Farmers Home Admin.*, 101 F.3d 574, 584 (8th Cir. 1996); *In re Cummings*, 214 B.R. 126, n.1 (D.N.J. 1997). The remainder of the allowed claim is treated and defined by section 506(a) as an "unsecured claim." As such, it does not enjoy the protections afforded to a "secured claim."

Section 506(a)'s bifurcation directive should be carried into section 506(d), just as the courts have carried section 506(a) into sections 506(b) and (c). *See, e.g., In re Gledhill*, 164 F.3d 1338, 1340 (10th Cir. 1999) (applying the section 506(a) definition of allowed secured claim to section 506(b)); *In re Golden Plan of Calif., Inc.*, 829 F.2d 705, 712 (9th Cir. 1986) (applying the section 506(a) "defin[ition of] allowed secured claim" to section 506(c)). It defies normal rules of statutory construction to hold that "allowed secured claim" holds one meaning in sections 506(a)–(c), and a different meaning in section 506(d). *See Dewsnup*, 502 U.S. at 422 (Scalia, J., dissenting) ("We have often invoked the 'normal rule of statutory construction that' 'identical words used in different parts of the same act are intended to have the same

meaning.'") (citing *Sullivan v. Stroop*, 496 U.S. 474, 484 (1990)).

Before *Dewsnup*, courts understood that, under the Code, liens were protected only to the extent of the value of collateral, and not to the full extent of the claim. *See, e.g., In re Briggs Transp. Co.*, 780 F.2d 1339, 1347 (8th Cir. 1985) ("[A]s a secured creditor, it will be paid in full up to the lien value of the collateral."); *Matter of Gifford*, 669 F.2d 468, 480 (7th Cir. 1982) ("Historically, lien rights have entitled their holders to the value of collateral and no more in bankruptcy."). In *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, this Court suggested that liens are only protected up to the collateral's value. 484 U.S. 365, 372 (1988) (herein "*Timbers*"). In *Timbers*, this Court held that undersecured creditors are not entitled to be compensated under section 362 for the delay in foreclosing on their collateral caused by the automatic stay. *See Id.* at 379. Thus, the Court in *Timbers* understood that what was protected by the provision for adequate protection under section 361 is the value of the collateral, and nothing else. In reaching this conclusion, *Timbers* used section 506(a)'s definition of "value of such creditor's interest" in section 506(a), *i.e.* "the value of the collateral," in reaching the conclusion that the phrase "value of such entity's interest" in section 361 has the same meaning as provided by section 506(a). *Id.* at 372. *Timbers*, therefore, strongly suggests that section 506(d) must be construed in the same manner, namely by only protecting a claim secured by property to the extent of the value of the property. Even after *Dewsnup*, courts continued to recognize that liens are only protected up to the value of the

collateral. *See, e.g.*, *Wade v. Bradford*, 39 F.3d 1126, 1129 (10th Cir. 1994) (stating that "*Dewsnup*'s holding cannot be imported into Chapter 11 cases"); *In re Pond*, 252 F.3d 122, 127 (2d Cir. 2001) ("[T]o determine whether a lien is 'secured' under Section 506(a), a court must examine the value of the collateral underlying a lien, not the value of the lien itself.").

Indeed, Congress itself understood that the Code was to treat undersecured creditors as having protection only to the extent of the value of the collateral, and thus did not protect valueless junior liens. The House Report in connection with the Bankruptcy Reform Act of 1978 states: "the bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor." H.R. Rep. No. 95-595, p. 181 (1977). Furthermore, Congress clearly intended for such protection to extend throughout the Code. H.R. Rep. No. 95-595, at p. 356 ("Throughout the bill, references to secured claims are only to the claim determined to be secured under this subsection [506(a)], and not to the full amount of the creditor's claim.").

2. The multiplicity of lien avoidance and modification provisions bears on the notion that section 506(d) authorizes stripoffs of valueless junior mortgages

Congress dealt in a comprehensive way with the treatment of liens under the Code. To do so, it had to deal with liens requiring special treatment other than because of the value of the collateral supporting them. There are many such provisions

in the Code. Section 506(d), on the other hand, is the provision addressing the treatment of liens based on the value of the collateral securing a claim.

Without regard to whether a lien is fully secured, undersecured, or valueless, multiple sections of the Code provide directly for lien avoidance. *See, e.g.*, 11 U.S.C. § 510(c)(1) (providing for equitable subordination of liens); 11 U.S.C. § 522(f) (providing for the avoidance of a lien to the extent it impairs an exemption of the debtor); 11 U.S.C. § 547(b) (providing for the avoidance of preferential liens); 11 U.S.C. § 548(a) (providing for the avoidance of a fraudulently incurred lien).

Numerous other Code sections cover situations in which certain liens may be subordinated, modified, or avoided completely. For example, section 364(d)(1), applicable in chapter 7 by virtue of section 103, authorizes the subordination of a pre-petition lien to a new senior mortgage if it is necessary for a trustee or a debtor in possession to obtain credit. This results in terminating the senior priority status of the prior lien and relegating it to a junior position behind a newly created senior lien. *In re Adams Apple, Inc.*, 829 F.2d 1484, 1490 (9th Cir. 1987) ("Congress provided in section 364(d) that pre-petition debts, even secured interests, may be subordinated by post-petition obligations . . . [I]t indicates a Congressional willingness to subordinate the interests of pre-petition creditors to the goal of rehabilitation."). Under this provision, a senior lien may be subordinated. Other special provisions of the Code dealing with the treatment of liens are sections 545, 552, and 724.

Thus, the old adage that "liens pass through bankruptcy unaffected" cannot be taken literally under the Code; that saying is, at best, misleading. Cases decided both before and after *Dewsnup* understood the fact that liens are regularly affected in bankruptcy. *Matter of Lindsey*, 823 F.2d 189, 190 (7th Cir. 1987) (calling the principle "no better than a half-truth"); *Harmon* 101 F.3d at 581 ("[I]t is not even accurate to say that liens pass through Chapter 7 unaffected."). Clearly, liens are affected by bankruptcy in innumerable ways, and thus do not "pass through bankruptcy unaffected."

B. Petitioner Reads Section 506(d) Only to Void a Lien that Secures a Claim Disallowed Under Section 502(b)(1). Congress Would Not Enact a Provision that is Superfluous

In its brief, petitioner contends that section 506(d) exists solely to establish the treatment of a secured claim that is disallowed under section 502, only voiding a lien because the claim it secures has been disallowed under section 502. Pet.Op.Br. at 32–33. This argument is fatally flawed, as section 506(d) would do nothing that does not already occur under state law, and would thus render section 506(d) superfluous. Under section 502(b)(1), a court determines the enforceability of a disputed claim after notice and hearing. Part of such a determination involves adjudicating the enforceability of the claim itself. *Katchen v. Landy*, 382 U.S. 323, 329 (1966); *Vanston Bondholders Protective Cmte. v. Green*, 329 U.S. 156, 170 (1946); *In re Hann*, 476 B.R. 344, 355 (1st Cir. B.A.P. 2012). Petitioner

erroneously contends that if a secured claim is disallowed under section 502(b), section 506(d) exists solely to invalidate the lien securing that claim. Such an interpretation would render section 506(d) superfluous, because such a reading of it would accomplish nothing more than what state law by itself already does.

Under state law, the vitality of a mortgage depends on the enforceability of the claim it secures; if a debt is unenforceable, so too is the lien securing it. *Carpenter v. Longan*, 83 U.S. (16 Wall) 271, 274 (1872) ("An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity . . ."); *Coon v. Shry*, 209 Cal. 612, 615 (1930) ("[T]he mortgage must stand or fall with the note . . . [A] mortgage or mortgage lien is a mere incident of the debt or obligation which it is given to secure. There cannot be a mortgage if there is no debt or other obligation to be secured.") (internal citations omitted). For instance, any attempt to assign a lien without assigning the debt underlying it is a nullity. *Jordan v. Sayre*, 24 Fla. 1, 19 (1888) ("It is true that an assignment simply of the mortgage or of the mortgagee's interest in the land, without the debt, is held to be a nullity."); *Flyer v. Sullivan*, 134 N.Y.S.2d 521, 523 (App. Div. 1st Dep't. 1954) (citing *Jackson ex dem. Curtis v. Bronson*, 19 Johns. 325, 326 (N.Y. Sup. Ct. 1822)); *Fassett v. Mulock*, 5 Colo. 466, 469 (1880); *Schleuter Co., Inc. v. Sevigny*, 564 N.W.2d 309, 314 (S.D. 1997); *Bryan v. Easton Tire Co.*, 262 Ark. 731, 732 (1978) ("The note and the mortgage are inseparable. An assignment of the note carries the mortgage, while an assignment of a mortgage alone is a nullity.").

Thus, by operation of state law, a lien is unenforceable if the underlying claim is unenforceable under applicable law or any agreement, and section 506(d) is not required to invalidate the lien. Therefore, reading section 506(d) as petitioner urges would render that subsection superfluous. Congress does not write superfluous or wasteful laws. *Knight v. C.I.R.*, 552 U.S. 181, 190 (2008) ("Thus, accepting the Trustee's approach 'would render part of the statute entirely superfluous, something we are loath to do.'") (citing *Cooper Indus., Inc. v. Aviall Svcs., Inc.*, 543 U.S. 157, 166 (2004)); *Kelly v. United States*, 826 F.2d 1049, 1052 (Fed. Cir. 1987) ("To [construe a statute in a superfluous way] would be to say that Congress wrote a meaningless provision into the law. We will not attribute such incompetence to Congress.") (internal citations omitted).

POINT III

BANKRUPTCY'S UNDERLYING GOAL TO PROVIDE DEBTORS WITH A FRESH START IS IMPORTANT IN CHAPTER 7

The pre-Code principle protecting mortgages only to the extent of the value of the collateral is supported by the bankruptcy law's fundamental goal of providing an honest debtor with a fresh start. The Court explicitly acknowledged this pre-Code principle. *See, e.g., Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) (noting that exemptions evidence the bankruptcy purpose to give the debtor a fresh start); *see also* H.R. Rep. 95-595, at p. 118 (1977) ("Whether the debtor uses chapter 7, liquidation, or chapter 13, adjustment of debts of

an individual, bankruptcy relief should be effective, and should provide the debtor with a fresh start."); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007) ("The principal purpose of the Bankruptcy Code is to grant a fresh start to an honest but unfortunate debtor.") (internal citation omitted).

Stripoffs enable debtors to retain their property. For example, freeing the debtor's property from a wholly underwater junior lien would enable the debtor to negotiate with the primary lender to reach an agreement that reduces the mortgage debt to the value of the property and avoids foreclosure. After a bankruptcy, this could enable the debtor to retain the property and also yield a greater recovery by the first mortgagee than could be otherwise realized in a foreclosure sale. However, such an agreement cannot be implemented without the consent of the holder of a junior mortgage on the property, and the junior mortgagee is thus in a position to block such an agreement. The holder of a valueless junior mortgage, which would be wiped out by a foreclosure of the first mortgage, has no economic interest in withholding its consent, except to block such an agreement until it is able to extract a payment on its valueless mortgage. This is good reason to allow the stripoff of valueless second mortgages. Surely Congress did not intend to protect the ability of the holder of such a mortgage to obtain a payment in that manner, in preference to the debtor's fresh start.

With respect to individuals especially, the ability to remain in their homes should be recognized as a more important interest than that of the holder of a wholly underwater junior mortgage. Bankruptcy exemption laws protect the

debtor's property, and particularly protect a debtor's continued ownership of his or her home. The purpose of the exemption statutes should guide the Court's determination of how mortgages are treated in bankruptcy cases. *See In re Bartlett*, 168 B.R. 488, 493–94 (Bankr. D.N.H. 1994) (noting that at its core, a "'fresh start' is only feasible if the debtor emerges from bankruptcy with a means of providing the necessities of life, including a roof overhead, and the homestead exemption is directed at making this attainable."). In that light, a valueless second mortgage should be subject to being stripped off as a means of furthering the debtor's continued home ownership and fresh start.

Moreover, as noted earlier, petitioner and its *amici* have not offered a cogent economic basis for precluding stripoffs of valueless junior mortgages in chapter 7 cases. Their attempt to protect on-going investment opportunities for private equity firms by means of high-yield second mortgages does not support the dire consequences they predict will result from allowing such stripoffs. However, no such concern has been expressed in this case by the United States. The United States did express a concern for the strip down of *first* mortgages in its *amicus* brief filed in *Dewsnup*. It chose *not* to file an *amicus* brief in this case, suggesting that it is not concerned that such consequences will result from allowing stripoffs of valueless second mortgages. The concern of petitioner's *amici* is unwarranted, and should be directed to the Congress, not this Court.

CONCLUSION

Based on the foregoing and on respondents' brief, the order appealed from should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF COMMUNITY BANKERS ASSOCIATION OF ILLINOIS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

The Community Bankers Association of Illinois ("CBAI", or "Amicus Curiae CBAI") is a not-for-profit trade organization that was formed in 1974 to represent the interests of community banks. Community banks are state and federally chartered banks, typically with only one or very few (under five) branches, which primarily serve the interests of consumers and small businesses within a relatively small geographical area or community.

Illinois historically prohibited branch banking, and it was not until 1993 that all restrictions on branch banking were removed. Ill. Public Act 88-4 (1993) now codified at 205 ILCS 5/5(15). As a result, there are hundreds of community banks. Most are small banks, but all are vitally important to the communities they serve. They are not all, however, confined only to rural areas or small towns. Many community banks are located in metropolitan areas, including in the City of Chicago.

CBAI represents approximately 400 financial institutions in Illinois, which comprise approximately

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[1] Respondents have filed with this Court a blanket consent to *amicus* briefs. Petitioner has furnished a written consent to the filing of this brief, and a copy of that consent has been filed with this Court concurrently with the filing of this brief. No counsel for a party authored any part of this brief. No person, other than the Amicus Curiae CBAI or its counsel, has made a monetary contribution toward the preparation or submission of this brief. The law firm of SmithAmundsen LLC is an associate member of CBAI. The below signed Counsel of Record, as well as the individuals who are identified as Of Counsel, are partners in the firm of SmithAmundsen LLC.

70% of all bank and thrift charters in Illinois. CBAI also represents 150 associate members, consisting primarily of vendors that provide services to financial institutions, such as accountants, attorneys, and information technology providers. CBAI's statement of purpose declares, among other things, that "CBAI member banks and associate members share a common belief that community banks must survive, due to their role as primary lenders to consumers and small businesses that create more new jobs than other sector of our economy." Its mission statement accordingly provides, among other things: "The CBAI is dedicated to keeping community banks competitive for the benefit of their customers and communities they serve through delivery of quality education, effective political representation, and essential products and services."

CBAI's member banks, with clientele consisting mostly of consumers and small businesses, often lend money and take back junior mortgages on real estate to secure such loans. CBAI very conservatively estimates that there is at least $9.6 billion of outstanding debt secured by junior mortgages in Illinois,[2] and the actual

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[2] CBAI does not keep records of its members' collective aggregate second mortgage lending activity. Diligent research has found no published source estimating aggregate junior mortgage debt in Illinois. However, according to the U.S. Census Bureau, there were an estimated 15,773,702 housing units in the United States subject to some form of junior lien in 2013. United States Census Bureau, http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_13_1YR_B25081&prodType=table. Illinois has 4.072% of the population of the United States, United States Census Bureau, www.census.gov/popest/data/state/totals/2014/index.html, and CBAI estimates that Illinois should accordingly have about 4% of junior liens, which works out to

amount could be as high as $32 billion.[3] Nationally, the bulk of second liens are in the form of home equity lines of credit ("HELOCs") which take the form of revolving debt, and the balance is in the form of closed-end second liens ("CESs").[4]

CBAI is deeply concerned that a substantial portion of junior liens would be jeopardized by upholding the Eleventh Circuit Court of Appeals' decisions below that permit wholly underwater junior liens to be stripped-off or voided in bankruptcy. Nationwide, second liens represent an amount of money equaling more than one-half of all bank capital.[5] In addition, to the national impact, there would be significant and disproportionate impact upon community banks. Owing to their generally small size, community banks are least equipped to withstand the adverse impact of any lien being voided. Accordingly, for the foregoing practical reason and for the legal reasons argued below, Amicus

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642,305 units. Very conservatively estimating the average second mortgage to be $15,000.00, the resulting junior indebtedness in Illinois is $9,634,575,000.00.

[3] The Federal Reserve Bank estimated that, in 2012, aggregate national junior mortgage debt was in excess of $800 billion. *A New Look at Second Liens*, Federal Reserve Bank of New York, Staff Report 569 (Aug. 2012), at 1. Assuming Illinois' ratable share of that debt to be 4%, in accordance with its share of the national population, n.1, *supra*, the resulting amount of second mortgage debt in Illinois is about $32 billion.

[4] Ibid.

[5] *A New Look At Second Liens*, *supra*, n. 3, at 1.

Curiae CBAI joins Petitioner in respectfully urging reversal of the decisions below.

SUMMARY OF ARGUMENT

A. Factual Background

In each of these consolidated cases[6], Petitioner held a second lien on Respondents' respective residences. In each case, the court below voided ("stripped-off") Petitioner's junior lien based on a judicial determination that the lien had no monetary value at the time of the debtor's discharge in bankruptcy. The debtors, however, retained their respective properties to which the liens had previously been attached. Petitioner, accordingly, lost the opportunity to recover any of its indebtedness from possible future appreciation of the properties. Had Petitioner's liens been allowed to pass through bankruptcy unaffected, in accordance with century-old practice, Petitioner would have had a chance to recover something in the future, rather than being judicially sentenced to recover nothing. Petitioner was therefore deprived of a valuable right, even though, at a particular moment in time, its liens supposedly would have recovered no value from a liquidation sale.

B. Reasons To Reverse The Court Below

CBAI respectfully submits that for the following reasons, a lien cannot be stripped-off, and a creditor

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[6] *Bank of America, N.A. v. Caulkett*, Case No. 13-1421, hereinafter sometimes "*Caulkett*" and *Bank of America N.A., v. Edelmiro Toledo-Cardona*, Case No. 14-163, hereinafter sometimes "*Toledo-Cardona*"

cannot be denied future possible recovery merely because, at a single moment in time, that lien is judicially determined to have no recoverable value.

First, stripping-off liens is precluded by this Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992) ("*Dewsnup*"). As shown within, *Dewsnup* forbids stripping-down a lien, and its rationale equally precludes stripping-off a lien.

Second, stripping-off junior liens removes valuable property rights. That, in turn, implicates constitutional concerns. The Fifth Amendment to the Constitution of the United States provides, in relevant part, "No person shall be ... deprived of ... property without due process of law; nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V. Further, stripping-off valuable property rights violates Congressional policy to protect lienholders. Finally, even though liens may be stripped in Chapter 13 and Chapter 11 reorganization cases, it does *not* follow that they may be stripped in Chapter 7 liquidation cases for the reasons discussed *infra*.

Third, lienholders have a settled expectation, in reliance on this Court's prior cases, including *Dewsnup*, that liens will pass through bankruptcy unaffected. That expectation strongly militates against now permitting liens to be stripped-off.

Each of the above reasons, which are elaborated *infra*, is alone a sufficient reason to reverse the decision below of the Eleventh Circuit.

ARGUMENT

POINT I:
DEWSNUP PRECLUDES STRIPPING-OFF LIENS

The question posed in *Dewsnup* was, "[m]ay a debtor 'strip down' a creditor's lien on real property to the value of the collateral, as judicially determined, when the value is less than the amount of the claim secured by the lien?" *Dewsnup*, 502 U.S. at 411-412. At issue were conflicting interpretations of § 506(d), which provides, in relevant part: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void ..." 11 U.S.C. § 506(d).[7] The Petitioner in *Dewsnup* argued that under § 506(a), a claim is secured only to the extent of the (judicially determined) value of the lienholder's interest and is otherwise unsecured.[8] Petitioner then proceeded to infer that, to the extent the claim is unsecured under § 506(a), it is not an "allowed secured claim" under § 506(d). See *Dewsnup*, 502 U.S. at 414.

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[7] All references to sections or chapters are to those of the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

[8] 11 U.S.C. § 506(a)(1) provides, in part: "An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim."

Respondent, on the other hand, argued that § 506(d) is not "rigidly tied" to § 506(a) because § 506(a) classifies claims for distribution purposes, while the avoidance provision of § 506(d) is "directed to the time at which foreclosure is to take place." *Id.*, 502 U.S. at 415.

This Court squarely resolved that conflict: "We hold that § 506(d) does *not* allow petitioner to 'strip down' respondents' lien ..." *Id.*, 502 U.S. at 417 (emphasis added). The Court relied heavily on the absence of express Congressional intent to abrogate the pre-Code rule that liens pass through bankruptcy unaffected.

> "...given the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected."

Dewsnup, 502 U.S. at 417.

Further, in finding it "not plausible" to think Congress had impliedly created a new remedy, this Court stated:

> " ... to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles."

Dewsnup, 502 U.S. at 420.

The only factual difference between these instant cases and *Dewsnup* is that in *Dewsnup*, the Petitioner sought to reduce (strip-down) the value of the lien to an

amount less than the debt but greater than zero, whereas in these cases, the Eleventh Circuit stripped-off liens by reducing their value to zero. But that factual difference does not change the outcome, given the *ratio decidendi* in *Dewsnup*. It makes no sense to say that Congress created no implied remedy of stripping *down* a lien, but that the very same statutes do create an implied remedy of stripping *off* a lien. It is as if a rule forbidding wounding were understood to allow killing.

Indeed, every United States Circuit Court of Appeals which has considered the issue, except for the Court of Appeals for the Eleventh Circuit, has concluded that *Dewsnup* forbids stripping-off liens. *See*, *Ryan v. Homecomings Financial Network*, 253 F.3d 778, 782-783 (4th Cir. 2001) ("*Ryan*") (lien may not be stripped-off pursuant to provisions of §§ 506(a) and (d)); *In re Talbert*, 344 F.3d 555, 560-561 (6th Cir. 2003) (*Dewsnup* applies "with equal force and logic" and a Chapter 7 debtor may not strip-off a valueless junior lien), and *Palomar v. First American Bank*, 722 F.3d 992, 994 (7th Cir. 2013) (the only lien that can be voided by § 506(d) in whole or in part is a lien securing a claim rejected in whole or in part; statute has "no application" to a case where the junior lienholder has an allowed claim).[9]

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[9] Cases holding that *Dewsnup* forbids stripping-off liens exist at the sub-circuit level in a number of important jurisdictions. *See*, notably, *Laskin v. First National Bank of Keystone*, 222 B.R. 872 (9th Cir. BAP 1998). *See also*, *In re Swiatek*, 31 B.R. 26 (Bankr. D. Del. 1999) (*Dewsnup* reasoning applies whether a lien is partially or wholly unsecured); *In re Pistritto*, 2005 WL 906370 at *2 (Bankr. D. Del. 2005) ("courts in this Circuit generally conclude

Notably, in the decisions below, the court did not engage in an exegesis of *Dewsnup*, but instead relied on *McNeal v. GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012) (*"McNeal"*) (per curiam), which reaffirmed the Eleventh Circuit's pre-Dewsnup decision in *Folendore v. United States Small Business Administration*, 862 F.2d 1537 (11th Cir. 1989) (*"Folendore"*) to conclude that a wholly unsecured claim is voidable under § 506(d).[10] In *McNeal*, the court below held that, as a matter of its own internal jurisprudence regarding *stare decisis*, " ... a later panel may depart from an earlier panel's decision only when an intervening Supreme Court decision is 'clearly on point'." *McNeal*, 735 F.3d at 1265. The Eleventh Circuit went on to hold that *Dewsnup* was "not 'clearly on point'" because *Dewsnup* addressed "only" a strip down "and did not address a 'strip off'" *Id.* at 1265. Quoting one of its earlier cases, the Eleventh Circuit Court of Appeals then said:

> "[T]hat the reasoning of an intervening high court decision is at odds with that of our prior decision is no basis for a panel to depart from our prior decision."

Id., quoting *Atlantic Sounding Co., Inc. v. Townsend*, 496 F.3d 1282, 1284 (11th Cir. 2007). The decisions

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that a debtor may not strip off a lien in a Chapter 7 case under section 506(d)."); *In re Caliguri*, 431 B.R. 324 (Bankr. E.D.N.Y. 2010).

[10] The opinion below in *Caulkett* is unpublished, and is included as Appendix A the Certiorari Petition in *Caulkett*. The opinion below in *Toledo-Cardona* is unpublished, and is included as Appendix A to the Certiorari Petition in *Toledo-Cardona*.

below were thus predicated entirely on intra-circuit *stare decisis* rules, and not upon any analysis of how the reasoning of *Dewsnup* does or does not apply to stripping-off liens. Plainly, however, in light of *Dewsnup*, the decisions below should be reversed.

POINT II: JUNIOR LIENS ARE PROPERTY RIGHTS THAT REQUIRE PROTECTION

A. A Wholly Underwater Lien is a Valuable Property Right.

Amicus Curiae CBAI submits that a wholly underwater junior lien is still demonstrably a valuable property right. Property values fluctuate; a junior lien which is wholly underwater today may acquire value as the underlying property appreciates in the future. As the court noted in *Ryan*, "we are acutely aware that in the volatile, modern real estate market, substantial price variations do occur with weekly or monthly regularity." *Ryan*, *supra*, 253 F.3d at 783. The *Ryan* court's observation is empirically proven by the decline in negative homeowner equity that is accompanying the current economic recovery:

> "...the national negative equity rate continued to decline in Q2 2014, falling to 17 percent, down 14.4 percentage points from its peak (31.4 percent) in the first quarter of 2012." Negative equity has fallen for nine consecutive quarters as home values have risen."

Zillow Real Estate Research, www.zillow.com/research/2014-q2-negative-equity-report-7465/.

Given aggregate mortgage debt of over $13 trillion[11], the cited decline in negative equity represents perhaps as much as $1 trillion dollars of now recoverable value that was not available only two years ago. The cited decline in negative equity also means that about 7 million mortgages which were underwater barely over two years ago are no longer underwater today.[12] A substantial number of both first and second mortgages have gone from being undersecured to being fully secured, including presumably some second mortgages that formerly were wholly unsecured.

A lienholder's property right to take advantage of future increases in value of the property was recognized in *Dewsnup*,

> "Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors ... who had nothing to do with the mortgagor-mortgagee bargain."

Dewsnup, 502 U.S. at 417.

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[11] Aggregate national mortgage indebtedness is in excess of $13 trillion as of the third quarter of 2014. *See*, http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm.

[12] There were approximately 49.5 million residential properties with mortgages at the end of the second quarter of 2014. *See*, http://www.corelogic.com/about-us/news/corelogic-reports-946,000-residential-properties-regained-1-trillion-dollars-in-total-equity-in-q2-2014.aspx. Consequently, a 14.4 percentage point decline in the negative equity rate implies that over 7 million residential mortgages have gone from underwater to fully secured.

Because future appreciation may create realizable value, it is fundamentally fallacious to confuse a lien's liquidation value at a particular moment in time with the value of the *property right* which that lien represents. Amicus Curiae CBAI submits that because a lien's value transcends its momentary monetary liquidation value, a lien having a current judicially determined (that is to say, hypothetical) value of $0 is nevertheless entitled to protection.

B. Stripping-Off Liens Raises Constitutional Concerns.

Dewsnup was not expressly decided on constitutional grounds. Rather, as discussed above, this Court resolved the issue of statutory construction on the basis of preserving the pre-Code practice that liens pass through bankruptcy unaffected, citing both policy considerations and a lack of expressed Congressional intent to abrogate pre-Code practice. However, *Dewsnup* was decided in the context of a constitutional backdrop that liens are to be protected against judicial (i.e., government) takings. This Court's cognizance of that constitutional background is implicit in *Dewsnup's* mention, 502 U.S. at 419, of *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) ("*Radford*") (per Brandeis, J.), discussed below. And while this Court can easily resolve the instant case in Petitioner's favor merely by applying the analysis in *Dewsnup*, Amicus Curiae CBAI submits that the constitutional significance of property rights in bankruptcy reinforces that strip-offs should not be allowed in Chapter 7 cases.

In *Radford*, this Court considered the constitutionality of portions of the Frazier-Lemke Act,

former 11 U.S.C. § 203(s). In particular, paragraph 7 of that Act provided, among other things, for a 5-year judicial stay of foreclosure proceedings with an option for the debtor to acquire full title and possession of mortgage property (as well as to obtain a bankruptcy discharge) by paying over the appraised value of the property. *See, Radford*, 295 U.S. at 575-576. Writing for a unanimous Court, Justice Brandeis bluntly recognized that the Frazier-Lemke Act's "avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' [i.e., strip-down the lien] to the present value of the property." *Radford*, 295 U.S. at 594. The Court then invalidated the Frazier-Lemke Act on constitutional grounds:

> "The province of the Court is limited to deciding whether the Frazier-Lemke Act ... as applied has taken from the bank without compensation, and given to Radford, rights in specific property which are of substantial value ... As we conclude that the act as applied has done so, we must hold it void; for the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation."

Radford, 295 U.S. at 601-602.

Amicus Curiae CBAI recognizes that the reach of *Radford* may be somewhat uncertain. That case involved the passage of a statute after the creation of a lien, where the statute modified lienholder rights. No such intervening statute is present in these cases. Amicus Curiae CBAI also recognizes that cases subsequent to *Radford* seem to focus on protection of

lien *value* existing at the time of bankruptcy. *See*, *Wright v. Central Life Ins. Co.*, 311 U.S. 273, 278 (1940) (no constitutional right beyond protection of the value of the property).[13] *See also*, *United Savings Association of Texas v. Timbers of Inwood Forrest, Ltd.*, 484 U.S. 365, 377 (1988) (under § 1129(b)(2), "undersecured creditor's 'interest' is regarded (properly) as solely the value of the collateral").[14] And Amicus Curiae CBAI recognizes that this Court chose not to predicate its holding in *Dewsnup* directly upon *Radford's* constitutional analysis, although nothing in *Dewsnup* prevents or precludes so applying *Radford* then or to these cases.

That having been said, there is no dispute that a lien is a property right, and that its value is entitled to protection as a constitutional matter. *See*, *Wright*,

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[13] *Wright* involved a statutory construction issue whether a debtor's right to redeem could be defeated by a creditor's right to compel sale. 311 U.S. at 278. It was not necessary to the holding in *Wright* for the Court to say there was no constitutional right beyond protecting the value of the property; it would have been enough to have said that constitutional minima for an underwater first lien are satisfied by preservation of value. A statement beyond that is dictum, and should not be considered as an implied holding that wholly underwater liens have no right to constitutional protection. *See*, *Humphrey's Executor v. United States*, 295 U.S. 602, 626 (1935) ("*Humphrey's*") (expressions beyond the point involved do not come within the rule of *stare decisis*).

[14] *Timbers* involved whether an undersecured creditor is entitled to immediate foreclosure or accrual of post-petition interest on its claim. The referenced remark was a dictum, per *Humphrey's*, n. 13, *supra*, particularly since the word 'properly' was put in parentheses.

supra, 311 U.S. at 278. *See also*, *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935) ("*Murel*") (per Hand, J.) ("adequate protection" requirement of former 11 U.S.C. § 207(c)(10) must conform to constitutional limitations).[15] However, just because a junior lien has no realizable monetary value at a given moment in time does *not* entail that such a lien encompasses no rights and has no value worthy of protection. It is *not* inconsistent with the jurisprudence of this Court to date to say that the right to future appreciation in lien value is a right entitled to protection on constitutional grounds, and that such right may not be removed by judicial fiat.

At a minimum, the foregoing discussion illustrates a constitutional backdrop which reinforces why *Dewsnup* should be applied to forbid lien strip-offs and show the enormous stakes involved in protecting junior liens even if they are (momentarily) wholly underwater. Of course, nothing precludes this Court from reversing the court below on constitutional grounds.

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[15] Notably, Judge Hand's constitutionally-driven formula that adequate protection must afford the "indubitable equivalence" of the lien, *Murel*, 75 F.2d at 942, was legislatively incorporated twice into the Bankruptcy Code. Section 361 lists "indubitable equivalent" as among the means of providing adequate protection. And Section 1129(b)(2)(A)(iii) lists "indubitable equivalent" as among the required minimal treatment alternatives for a secured claim in a cram-down situation.

C. The Policy of the Bankruptcy Code is to Protect Liens.

Further, whatever the constitutional backdrop, drafters of the Code were explicit that they desired statutory protections for liens as a matter of policy:

> "It is not intended to be confined to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds."

H.R. Rep. No. 595 at 339, 1978 U.S. Code Cong. & Ad.News at 6295.

The legislative history goes on to state:

> "*Secured creditors should not be deprived of the benefit of their bargain*. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognized the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for."

Id. (emphasis added).

Most bluntly, the way to not deprive a wholly underwater junior lien of the benefit of the bargain is to let the lien pass through bankruptcy unaffected. Even if such passing-through is not constitutionally

required, it nevertheless would reflect the policy of the Code. Outcomes which harmonize with Congressional policy and interest are to be preferred. *See e.g., Air Line Pilots Association, International v. O'Neill*, 499 U.S. 65 (1991) (criticizing court below for failing to take into account strong public policy arguments). The decisions below should accordingly be reversed.

D. Lien Stripping in Chapter 13 and Chapter 11 Cases Does Not Support Lien Strip-Offs in Chapter 7 Cases.

Provisions in chapters of the Bankruptcy Code other than Chapter 7 that ostensibly permit lien stripping do not form compelling rationales to permit lien strip-offs in a Chapter 7 case. At the outset, lien stripping outside of Chapter 7 is not done under § 506(d), but is done under specific provisions of Chapters 13 and 11 which are not now before the Court and which were not before the Court in *Dewsnup*. At a statutory level, lien stripping not done under § 506(d) is simply inapposite to this case. Nevertheless, Chapter 13 and Chapter 11 provisions will now be addressed.

To the extent lien strip-offs are permitted in Chapter 13 cases,[16] the Court of Appeals for the Seventh Circuit has clearly explained why that would *not* justify lien strip-offs in a Chapter 7 case:

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[16] Chapter 13 prohibits lien stripping on mortgages which are the debtor's principle residences, 11 U.S.C. § 1322(b)(2), but ostensibly permits it for other liens. Notably, although § 1322(b)(2) does not, on its face, specifically permit the strip-off of a wholly underwater junior lien, many courts have concluded that such strip-offs are permissible. *See generally*, cases catalogued in *In re Davis*, 716 F.3d 331, 334-35 (4th Cir. 2013).

> "The strip-off right in a Chapter 13 is a partial offset to the advantages that Chapter 13, relative to Chapter 7, grants creditors, such as access to a larger pool of assets because the debtor must commit all disposable income for three to five years to repaying unsecured debts... The difference between Chapter 13 (also Chapter 11) and Chapter 7 is the difference between reorganization and liquidation."

Palomar v. First American Bank, supra, 722 F.3d 992, 995 (7th Cir. 2013) ("*Palomar*") (per Posner, J.)

Amicus Curiae CBAI notes that, in constitutional terms, Judge Posner's analysis suggests that Chapter 13 provides compensation (in the form of greater access to assets) for the taking of the lien. Chapter 7, of course, does not provide compensation, which is one reason why there are significant constitutional concerns with lien strip-offs in Chapter 7 cases even if strip-offs are permitted in Chapter 13 cases.

Nor are ostensible lien stripping provisions in Chapter 11 a true argument for permitting strip-offs in a Chapter 7 case. In the first place, *Palomar's* distinction, *supra*, between reorganization and liquidation is instructive. Chapter 11, like Chapter 13, is a reorganization which arguably affords at least some level of compensation for lien taking. Further, in a Chapter 11 case, a secured creditor may make the election provided by § 1111(b), which, in turn, entitles the lienholder to the treatment statutorily required by

§ 1129(b)(2).[17] Fundamentally, while this allows a lien to be stripped-down, it does not address stripping-off a lien.

It is true that there is no right to make the § 1111(b) election if the lien is of "inconsequential value." 11 U.S.C. § 1111(b)(1)(B)(i). Amicus Curiae CBAI submits, however, that the loss of the section 1111(b) election for liens of inconsequential value is *not* a warrant for lien strip-offs in Chapter 7 cases. Loss of the right to make the § 1111(b) election if the lien is of "inconsequential value" does not entail that voiding a wholly underwater lien is allowed. Loss of the election entails loss of the right for the *claim* to be treated under the Chapter 11 plan in accordance with the requirements of § 1129(b)(2). However, the loss of specific *claim* treatment is not the same as losing the lien. Indeed, since, under *Dewsnup* a lien with value cannot be stripped-down, and must pass through bankruptcy unaffected, the creditor's lien that has positive (but "inconsequential") value must pass through for the plan to comply with the requirement of § 1129(a)(7)(A)(ii) that the creditor receive at least which it would in a Chapter 7 liquidation case.[18] *See,*

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[17] If the property is sold, the creditor must be allowed to credit bid. 11 U.S.C. § 1129(b)(2)(A)(ii). If the property is retained by the debtor, the secured lender either gets the "indubitable equivalent", 11 U.S.C. § 1129(b)(2)(A)(iii), or must retain its lien and receive cash payments equaling the amount of the claim with a present value equal to the lien. 11 U.S.C. § 1129(b)(2)(A)(i).

[18] 11 U.S.C. § 1129(a)(7)(A)(ii) sets forth that among the requirements for confirmation of a Chapter 11 plan, that the holder of an impaired claim who has not accepted the plan "will receive or retain under the plan on account of such claim or

In re Stone & Webster, Inc., 286 B.R. 532, 545 (Bankr. D. Del. 2002) (best interest of creditors test of § 1129(a)(7) is a "guaranty" to each claim holder that it will receive at least as much in reorganization as it would receive in a liquidation).

Nor can it be argued that wholly underwater junior liens can be stripped-off in Chapter 11. That argument begs the question now before the Court: whether such liens can be stripped-off in Chapter 7. Only when that issue is resolved can it be known if the best interest of creditors test of § 1129(a)(7) permits such liens to be stripped-off under a Chapter 11 plan.

In sum, lien stripping provisions in Chapters 13 and 11 do not provide a warrant for stripping-off liens in Chapter 7 cases. Accordingly, the decisions below should be reversed.

POINT III:
ALLOWING A LIEN TO BE STRIPPED-OFF BASED ON A JUDICIAL DETERMINATION OF VALUE RISKS UNJUSTLY VOIDING LIENS THAT IN REALITY ARE NOT WHOLLY UNDERWATER

Dewsnup clearly forbids stripping-down a lien if that lien has one cent or more of realizable value. Such a lien may pass through bankruptcy unaffected, and the lienholder may benefit from future appreciation. The consequence of Respondent's position, however, is

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interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7 of this title on such a date..."

that if the same lien is wholly underwater by one cent, it can be voided. Thus, a one cent difference in a judicially determined valuation would make the difference between preservation of a right and its complete and permanent loss.

Unfortunately, in the real world, judicial determinations of value are not inerrant. Such determination rest on appraisals.

> "But errors in appraising a house are common because 'real estate appraisal is not an exact science ... common enough to have created a market for 'Real Estate Appraisers Errors & Omissions insurance policies."

Swanson v. Citibank, N.A., 614 F.3d 400, 408 (7th Cir. 2010) ("*Swanson*") (Posner, J., dissenting in part)(internal citation omitted).

Indeed, an appraisal, by definition, is an opinion of value. *See, The Appraisal of Real Estate*, 14 ed., p 2 (Appraisal Institute, 2013). Frequently, different methods are employed which lead to disparate results, which then must be reconciled, leading to a final opinion expressed across a range of value. *Id., 641-646. Cf, Silverman v. Commissioner of Internal Revenue*, 538 F.2d 927, 933 (2d Cir. 1976) (valuation is necessarily an approximation); *In re R & H Investment Co., Inc.*, 46 B.R. 114, 116 (Bankr. D. Conn. 1985) (court can only make 'reasonable estimate' of value); *In re Jug End in the Berkshires, Inc.*, 46 B.R. 892, 900 (Bankr. D. Mass. 1985) (no property value determined by appraisal rests on scientific analysis). And opinions, no matter how informed and educated, can err. Placing the survival of a right on a process in which errors are

too common is simply antithetical to that right. The rule urged by Respondent will inevitably result in some junior liens being voided, even though they are not wholly underwater, merely because someone estimates they are wholly underwater.

In a closely related context, even the Eleventh Circuit Court of Appeals recognized the perils of relying on the inherently inexact appraisal process. In *In re Dickerson*, 222 F.3d 924 (11th Cir. 2000), the court convincingly criticized its own precedent even while permitting lien stripping in a Chapter 13 context.[19] It stated:

> "However, were we to decide this issue on a clean slate, we would not so hold. We find persuasive the district court's reasoning that providing 'anti-modification' protection to junior mortgagees where the value of the mortgaged property exceeds the senior mortgagee's claim by at least one cent, as prescribed by the Supreme Court's decision in *Nobleman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993), but denying that same protection to junior mortgagees who lack that penny of equity, places too much weight upon the valuation process. As we have noted, '[v]aluation outside the actual market place is inherently inexact." *Rushton v. Commissioner of Internal Revenue*, 498 F.2d 88, 95 (5th Cir. 1974). *Given the unavoidable imprecision and*

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[19] *See infra.*, beginning at p. 17 for a discussion of why lien stripping in Chapter 13 is *not* a basis for allowing strip-offs in Chapter 7 cases such as the instant ones now before the Court.

> *uncertainty of the valuation process, we think that choosing to draw a bright line at this point is akin to attempting to draw a bright line in the fog."*

Id. at 926. (emphasis added).

Nor is simple error in estimating value the only, or even the largest, risk. Cases frequently occur in which a court is asked to resolve extremely differing appraisals. *See, e.g., CSX Transportation, Inc. v. Georgia State Board of Equalization*, 552 U.S. 9, 14 (2007) ($4.6 million vs. $7.8 million for real property); *In re Morysville Body Works, Inc.*, 86 B.R. 51, 52 (Bankr. E.D. Pa. 1988) ($375,000.00 vs. $934,000.00); *Swanson, supra*, 614 F.3d at 403 ($170,000.00 v. $240,000.00). The difficulty with situations where disparate appraisals are presented is that genuine accuracy is often impossible. In *In re Rogers Development Corp.*, 2 B.R. 679, 684-85 (Bankr. E.D. Va. 1980) ("*Rogers Development*"), the court was faced with disparate appraisals of $801,000.00 and $704,000.00 and concluded that the difference was properly attributable to a difference of professional opinion. Perhaps predictably, the Court split the difference and found the property to be worth $750,000.00. *Id.* Consider, however, a *Rogers Development* situation in the world Respondent would create. Assume there is a $150,000.00 first mortgage and a $50,000.00 junior mortgage. Further assume that conflicting appraisals for the property come in at $185,000.00 and $215,000.00. What is the fate of the second lien?

It is particularly troubling that a second lien could be lost when it is only dubiously wholly underwater. Admittedly, the courts do resolve valuation issues

routinely, but this does not mean judicial determinations of value are an optimal means of determining value. An appraisal is a technique for estimating value when an actual sale cannot take place, as in a condemnation proceeding, or, as with many "fairness opinions," an actual sale takes place under non-competitive conditions necessitating some estimate of how the asset would fare in fully competitive setting.

Where appraisals can be avoided in deference to the market, they should be avoided. Bankruptcy presents many circumstances where reliance on appraisals is avoided by recourse to the market. In at least two bankruptcy circumstances, this Court has deferred to the market to determine value rather than rely on appraisals. First, in *Bank of America National Trust and Savings Association v. 203 North LaSalle St. Partnership*, 526 U.S. 434 (1999), ("*203 N. LaSalle*"), this Court held that a debtor's equity owners may give subsequent new value to retain equity (assuming *arguendo* an exception to the absolute priority rule) only if the equity interest is exposed to competing bids in the market, or others are given the opportunity to propose a competing plan. *See*, 526 U.S. at 454 and 458. This Court declined to allow equity to be retained based on merely a judicial determination (appraisal) of the value of equity.

Second, in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (2012)("*RadLAX*"), this Court re-affirmed as inviolate the right to credit bid in sale held under Chapter 11 plans. *RadLAX* assures that the lien holder cannot be deprived of the value of its lien by a judicial determination of that

value, but rather only by the lienholder's own assessment of the property's value and voluntary decision not to credit bid. Nothing in *RadLAX* limits it to senior mortgages or precludes its application to wholly underwater liens. An underwater junior lien should be able at a foreclosure sale to pay off the senior lien and credit bid some or all of the junior debt. That outcome, of course, reflects the basic bargain between the mortgagor and mortgagee, and also puts the lienholder in charge of what investment to make to protect its interest in property, which is the antithesis of a government (judicial) decision whether to take away that interest without compensation.

In short, an important implication of cases such as *RadLAX* and *203 N. LaSalle* is that judicial determinations of value are disfavored to limit rights (or eliminate rights, as Respondent would do in this case) where a market-based alternative is available. In this case, such an alternative is available: let the lien pass through bankruptcy unaffected as has been the rule for well over a century. The decisions below should be reversed.

POINT IV:
LENDERS HAVE A SETTLED EXPECTATION THAT LIENS WILL PASS THROUGH BANKRUPTCY UNAFFECTED

The principle that liens pass through bankruptcy unaffected was recognized in, but clearly predates, *Long v. Bullard*, 117 U.S. 617, 620-21 (1886). It has thus been highly settled law for more than 125 years that liens pass through bankruptcy unaffected. *See also, Dewsnup*, 502 U.S. at 418, citing *Farrey v. Sanderfoot*, 500 U.S. 291, 297 (1991). *Cf., Palomar,*

supra, 722 F.3d at 993, describing the principle that liens pass through bankruptcy unaffected as a "venerable principle." The ability to ride-out downward fluctuations in value is vital to mitigating creditor risk, and is thus a factor that affects, in the first instance, the decision whether to extend credit *at all*, and in the second instance, what interest rate to charge.

There can be no doubt that lenders rely on the "venerable principle" that liens pass through bankruptcy unaffected. Indeed, not only case law but legislative history buttresses such reliance. Strikingly, the House Committee Report on the Bankruptcy Code stated point-blank: "[s]ubsection (d) permits liens to pass through bankruptcy unaffected." HR Rep. No. 95-595 at 357 (1978). Failure to reverse the decisions below will jeopardize a significant portion of hundreds of billions of dollars in junior mortgage debt that has been extended, at least in part, on reliance that liens pass through bankruptcy unaffected.

It seems inconceivable that any mortgage lender ever thought it would lose permanently its *legal* right to a lien because vicissitudes in the real estate market temporarily deprived a junior lien of recoverable value. Instead, lienholders understand that a lien reflects the basic combining of *in personam* and *in rem* relief, which is a hallmark of bankruptcy, and which was recognized in a different context by this Court and expressed as follows: "Rather a bankruptcy discharge extinguishes only one mode of enforcing a claim – namely, an action against the debtor *in personam* – while leaving intact another – namely, an action against the debtor *in rem*." *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991).

Pending the filing of Respondent's brief, it remains to be seen if Respondent will explicitly request that *Dewsnup* be overruled. But there should be no mistake: at least implicitly, the Respondent would overrule *Dewsnup* in the case of a wholly underwater lien. Thus, whether as an explicit or implicit matter, this case implicates the *stare decisis* treatment of *Dewsnup*. As this Court has stated:

> "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved."

Payne v. Tennessee, 501 U.S. 808, 828 (1991), and see the numerous cases therein cited.[20] *See also*, *Minnesota Co. v. National Co.*, 70 U.S. 332, 334 (1865):

> "...where courts vacillate and overrule their own decisions on the construction of statutes affecting the title to real property, their decisions are retrospective and may affect titles purchased on the faith of their stability. Doubtful questions on subjects of this nature, when once decided, should be considered no longer d[illegible]ibtful or subject to change."

Lien rights are property rights, and stripping-off a lien is every bit as severe as compromising title to real property. Hundreds of billions of dollars in credit

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[20] *Payne* was a criminal sentencing matter which chose to overrule a precedent involving, as the Court put it, mere "procedural and evidentiary rules." 501 U.S. at 828. However, the holding in *Payne* does nothing to negate the proposition for which it is cited above.

secured by junior liens has been extended by lenders believing that liens pass through bankruptcy unaffected, whether or not the junior lien is temporarily either partially or wholly underwater. That a lien passes through bankruptcy unaffected is a longstanding "rule of property" which stands at the "acme" of considerations of *stare decisis*. One thing is certain: the decisions below weakly distinguish the instant cases from *Dewsnup*, but express absolutely no basis for overruling *Dewsnup*. And reliance interests strongly mitigate against overruling *Dewsnup*.

Lastly, this Court has also stated that "considerations of stare decisis weigh heavily in the area of statutory construction where Congress is free to change this Court's interpretation of its legislation." *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977). Certainly, this reinforces the need to stand by *Dewsnup* insofar as *Dewsnup* was explicitly decided on statutory construction grounds.

It is clear that case law and legislative history provide that liens pass through bankruptcy unaffected. This court has been firm that a "clear, well established" and "basic" bankruptcy practice should not be eroded absent a "clear indication of Congressional intent. *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998). The Court has also said that state law property rights are not to be abrogated unless it is "clear and manifest" that Congress so intended. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 543-45 (1994).

Accordingly, when reliance interests, *stare decisis* considerations, Congressional intent, and rights under state law are combined, it is manifest that the decisions below should be reversed.

CONCLUSION

For each and every of the foregoing reasons, the decision of the Eleventh Circuit Court of Appeals should be reversed in both of these cases.

Respectfully submitted,

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Petitioner
v.
DAVID B. CAULKETT
Respondent

BANK OF AMERICA, N.A.
Petitioner
v.
EDELMIRO TOLEDO-CARDONA
Respondent

On Writs of Certiorari to the
United States Court of Appeals
for the Eleventh Circuit

BRIEF OF PROFESSOR MARGARET HOWARD AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICA[1]

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SUMMARY OF ARGUMENT

Dewsnup v. Timm, 502 U.S. 410 (1992), was wrongly decided and should be overruled. Its statutory methodology ignored both the plain meaning of the Bankruptcy Code and established principles of statutory construction. The outcome might be defensible had it vindicated congressional policies, but it contradicts them instead.

Dewsnup's result was not necessary to preserve creditors' rights to appreciation, whether during the case or later. Property rarely appreciates

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[1] No party or counsel for a party authored this brief in whole or in part or made a monetary contribution to its preparation or submission. Expenses for the preparation and submission of this brief were met exclusively from research funds available to Amica.

Counsel of record for petitioner and respondent granted permission for the filing of this brief.

during a chapter 7 proceeding because of its short duration. If appreciation does occur, lienholders' interests are fully protected by proper valuation as of the proper time. Thereafter, creditors can capture appreciation by reinvesting in a rising market. Institutional lenders may not be able to hold property for appreciation anyway, for statutory and regulatory reasons.

Congress enacted a targeted provision to deal with undersecured creditors' rights to appreciation—section 1111(b). It does not extend to creditors whose liens are "of inconsequential value," and, even when applicable, it does not assure creditors of any more than the present value of collateral supporting their claims.

Dewsnup erroneously believed that liens pass through bankruptcy unaffected. They do so only if bankruptcy's substantial avoiding powers are not brought to bear.

Under this Court's constitutional precedents, secured creditors must receive the value of collateral available for their claims, but not the collateral itself. That understanding is foundational in bankruptcy. The Code follows a "priority model" under which lienholders are assured the value of their secured claims, but not property rights in particular collateral.

Numerous sections of the Code, applicable in both liquidations and reorganizations, reflect the priority model: section 361, which lists ways of providing adequate protection, protects only value, not property rights; section 364(d) overrides secured

creditors' property rights by permitting liens to be demoted if necessary postpetition credit cannot otherwise be obtained; section 722 permits debtors to redeem certain property, eliminating encumbrances by paying the collateral's value; section 506(b) allows oversecured creditors to claim postpetition interest, but only up to the value of available collateral; and plan confirmation requirements in the reorganization chapters require payment only of the present value of secured claims.

When Congress intended to make exceptions, they are specific and narrowly drawn.

Even if *Dewsnup* is not overruled, it should not be extended to protect liens devoid of supporting value. *Dewsnup* protects "secured" claims and no claim is secured, as defined in section 506(a), in the absence of supporting value. In addition, extending *Dewsnup* would have negative inter-creditor effects and would give lienholders inappropriate leverage against both debtors and other creditors.

For these reasons, this Court should affirm the decisions below and overrule *Dewsnup* in the process.

ARGUMENT

I. *Dewsnup* was wrongly decided and should be overruled.

A. *Dewsnup* ignored both the plain meaning of the Bankruptcy Code

and established principles of statutory construction.

Dewsnup v. Timm, 502 U.S. 410 (1992), did not quarrel with bifurcation under 11 U.S.C. § 506(a)[2] of an undersecured claim into two claims—a secured claim, measured by the claimholder's "interest" in the collateral; and an unsecured claim, measured by the deficiency. Thus, when a claim is undersecured, the creditor's "allowed secured claim," as that phrase is used in subsection (a), is less than the amount of the debt. *Dewsnup* held, however, that the very same phrase, used in subsection (d), is to "be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Dewsnup*, at 415. Thus, the phrase "allowed secured claim," when used in section 506(a), means the claim measured by the value of the collateral, but the same phrase, used in section 506(d), means both parts of an undersecured party's claim—specifically, the full amount allowed under section 502.

This reading violates well-established rules governing statutory interpretation, beginning with the most fundamental rule of all—that plain language should be applied as written. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) ("It is well established that when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." (internal quotation marks omitted)).

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[2] Hereinafter references to the Bankruptcy Code are by section number alone.

A second, closely related, interpretive proposition, to which this Court has repeatedly adhered (*Dewsnup* being the notable counter-example), is the "normal rule of statutory construction" that "identical words used in different parts of the same act are intended to have the same meaning." *IBP, Inc. v. Alvarez*, 546 U.S. 21, 34 (2005); *Dewsnup*, at 422 (Scalia, J., dissenting). *Dewsnup* concluded that "allowed secured claim" has a meaning in subsection 506(d) different from its meaning in another subpart of the very same section, as well as elsewhere in the Code. This Court in other cases, however, has rejected this methodology of statutory construction. See, e.g., *U.S. v. Santos*, 553 U.S. 507, 522 (2008) (rejecting the argument "that one undefined word, repeated in different statutory provisions, can have different meanings in each provision," and "forcefully" rejecting the "interpretive contortion" that "proceeds" in federal money laundering statute can have different meanings "in the same statutory provision"); *Clark v. Martinez*, 543 U.S. 371, 378 (2005) (stating, in determining whether construction of language applicable to one category of inadmissible aliens also applies to another category, that "[t]o give these same words a different meaning for each category would be to invent a statute rather than interpret one").

The *Dewsnup* Court apparently believed that the language in subsection (d) is ambiguous. *Dewsnup* at 416 ("The foregoing recital of the contrasting positions of the respective parties and their *amici* demonstrates that section 506 of the Bankruptcy Code and its relationship to other provisions

of that Code do embrace some ambiguities."). This belief rested solely on the fact of disagreement among self-interested litigants. *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1273 (10th Cir. 2012) (*Dewsnup*'s finding of ambiguity was "based on no more than the fact the litigants before it happened to disagree over the statute's meaning"). Were that enough to render statutory language ambiguous, however, the plain meaning rule could never apply in a litigated case. See, e.g., *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999) (Thomas, J., concurring in the judgment) ("If litigants' differing positions demonstrate statutory ambiguity, it is hard to imagine how any provision of the Code—or any other statute—would escape *Dewsnup*'s broad sweep. A mere disagreement among litigants over the meaning of a statute does not prove ambiguity; it usually means that one of the litigants is simply wrong.").

Subsequent courts at every level, and many commentators, have found *Dewsnup*'s interpretive methodology unsupportable. See, e.g., *203 N. LaSalle* at 461 (Thomas, J., concurring in the judgment) (referring to *Dewsnup*'s mode of statutory analysis as "methodological error"); *Dewsnup*, at 420 (Scalia, J., dissenting) (stating that the majority "disregards . . . well-established principles of statutory construction"); *Dever v. IRS (In re Dever)*, 164 B.R. 132, 138 (Bankr. C.D. Cal. 1994) ("*Dewsnup's* result is hard to reconcile with the overall structure and language of the Code using normal principles of statutory construction."); David Gray Carlson, *Bifurcation of Undersecured Claims in*

Bankruptcy, 70 AM. BANKR. L.J. 1, 16 (1996) [hereinafter "Carlson, *Bifurcation of Undersecured Claims*"] (characterizing *Dewsnup*'s assignment of different meanings to "allowed secured claim" in §§ 506(a) and (d) as "overt interpretive violence"); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 26, 27 (1996) (referring to *Dewsnup* as a "disaster" and its statutory interpretation methodology as "faux textualism").

Criticism, despite being spot-on and nearly universal, may not be enough to justify the overruling of established precedent that is otherwise supported by Congress's articulated policies. Examination of *Dewsnup*, however, reveals that every premise on which the Court relied was flawed.

B. None of *Dewsnup*'s supporting rationales justifies its outcome.

The *Dewsnup* majority was apparently aware that its statutory methodology was dubious. *Dewsnup*, at 417 (noting its statutory reading was "not without its difficulty"). Thus, the Court sought to justify its conclusion by looking to legislative history and several policy-based concerns. The Court was attempting to reach the "right" result, despite statutory language pointing in a different direction. Reading section 506(d) to permit avoidance of liens unsupported by value, however, is neither absurd nor unconstitutional nor inconsistent with the Bankruptcy Code as a whole.

1. *Dewsnup* is not justified by an undersecured creditor's right to appreciation.

The *Dewsnup* Court was primarily concerned that stripdown would allow bankruptcy debtors to receive a "windfall" by cutting off undersecured creditors' access to future appreciation:

> The practical effect of [debtor's] argument is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some of the parties describe as a "windfall."

Dewsnup, at 417.

This supposed "windfall" is a complete mirage in most cases. In other cases, when appreciation is conceivable, the Bankruptcy Code provides ready protection for the undersecured creditor's legitimate concerns.

The average chapter 7 case is of relatively short duration.[3] Valuation determined as of filing is

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[3] Administrative Office of the United States Courts, *2013 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, Table 3 (2014) ("From filing to disposition, chapter 7 consumer cases closed in 2013 had a mean time interval of 212 days and a median time interval of 116 days.").

unlikely to differ in any significant amount from the value of the creditor's interest as of the date of stripdown. If the facts are otherwise in a particular case, however—either because the case is unusually prolonged or because of galloping appreciation—then undersecured creditors' concerns are fully addressed if the property is valued as of the time of lien avoidance, rather than the time of filing. Section 506(a)(1) provides ample authority for determining value, in a rising market, as of the later time: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." Authority is divided,[4] but courts are obviously free to time valuation as necessary to protect creditors' legitimate interests.

This approach provides complete compensation to the creditor for appreciation occurring up to the moment its secured claim is valued and paid, as well as for the likelihood of future appreciation. Under established principles governing appraisals and valuation, the likelihood of appreciation is accounted for in proper valuation of any type of property:

> [P]roper valuation subsumes all projections of future movements in the market. Such a valuation contemplates the possibility of an upside and a downside in future property values. If the property goes up in value, the

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[4] *Dewsnup* itself suggests the avoidance date, observing that postpetition appreciation "rightly accrues to the benefit of the creditor," *Dewsnup*, at 417; but section 502(b) states that courts shall determine the amount of claims to which objection is raised, "as of the date of the filing of the petition."

> secured party has already been compensated in the original valuation and therefore does not deserve the newly found surplus.

Carlson, *Bifurcation of Undersecured Claims*, at 17. See also Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 946 n.45 (1985) [hereinafter "Eisenberg, *Undersecured Creditor*"] ("An accurate appraisal would, of course, reflect the possibility of a future increase or decrease in value."); Int'l Valuation Standards Council, INT'L VALUATION STANDARDS 2013: FRAMEWORK AND REQUIREMENTS ¶ 103 (requiring, in valuing real property for purposes of secured lending, consideration of factors suggesting future increases in value: "anticipated future demand for the type of property and location," "potential . . . alternative uses that . . . can be anticipated," and "impact of any events foreseeable at the valuation date on the probable future value").

Thus, payment of the value of the secured claim, determined as of the appropriate moment, fully compensates the claimholder for appreciation occurring postpetition and pre-avoidance, as well as for the likelihood of future appreciation. Furthermore, the cashed-out creditor has complete control over the actual capture of additional future appreciation because that creditor can simply reinvest the proceeds in the rising market.

Even with their *in rem* rights intact, creditors may be unable to hold property and await appreciation. First, statutes and regulations restrict the

ability of many real estate lenders to speculate on future appreciation by bidding in the amount of their debts and holding property. See, e.g., 7 C.F.R. § 1955.102 (2014) (providing, upon foreclosure of FHA loans secured by real estate, that "[s]ales efforts will be initiated as soon as property is acquired in order to effect sale at the earliest practicable time"); 38 C.F.R. § 36.4283(f) (2014) (providing, upon foreclosure of loans guaranteed by VA, that the holder "shall resell the property within a reasonable time"). Second, foreclosed real estate held for appreciation may decrease a lender's ability to make other loans. See, e.g., 12 U.S.C. §§ 1464(c)(2) & (t)(1)(A) (2014) (limiting loans made by federal savings associations and secured by nonresidential real property to 400% of association's capital, and defining capital to account for nonproductive loans).

The stripped-down creditor suffers no more violation of its legitimate interests than does a seller who receives the price of its product in a rising market. The bankruptcy debtor enjoys no more of a "windfall" than does a buyer, when each pays the appropriate value of acquired property, as of the time of acquisition.

The key is that the stripped-down creditor receive the full amount of its interest. Tellingly, petitioner did not contest the bankruptcy courts' valuation determinations in either of the present cases. Brief for Respondents at 6.

Congress's concern about an undersecured creditor's access to appreciation is reflected in one and only one provision of the Bankruptcy Code—

section 1111(b). It was designed to reverse the result reached in a single pre-Code case, *In re Pine Gate Associates, Ltd.*, 2 B.C.D. (CRR) 1478 (Bankr. N.D. Ga. 1976), which permitted the debtor to pay the collateral's appraised value and to keep the property free of lien. Examination of section 1111(b) reinforces that Congress intended to protect only the *value* of liens and, additionally, only liens *with* value.

Creditors were unhappy about *Pine Gate* because, in part, they could not bid in the amount of their debts in the absence of public sale. Section 1111(b), therefore, permits an undersecured creditor to "elect" to have a secured claim measured by the amount of the debt rather than the value of the collateral, thus being treated as fully secured.

Ordinarily, chapter 11 provides that a debtor may satisfy an undersecured claim by paying the amount supported by value—that is, the "allowed secured claim"—plus interest, if payments are made over time, in order to provide present value as of the time the secured claim is satisfied.[5] Thus, if the

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[5] Absent the election, chapter 11 requires a stream of payments meeting two tests: first, a "principal amount" test, requiring "deferred cash payments totaling at least the allowed amount of" the claim; and second, a "present value" test, requiring payments having "a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." § 1129(b)(2)(A)(i). The present value test effectively requires debtors to pay interest, at an appropriate rate, when payments are made over time. Cf. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

The apparent redundancy of the requirements is necessary in order to accommodate the possibility of election.

debtor owes the creditor $25,000 and the obligation is secured by a lien on collateral worth $10,000, without the election the debtor must make payments of at least $10,000, plus appropriate interest. With the election, however, our debtor must make payments having a face amount of at least $25,000 and a present value of at least $10,000.

The section 1111(b) election assures that the undersecured creditor will enjoy the benefit of any appreciation to the property. Eisenberg, *Undersecured Creditor*, at 939 (stating that, upon election, the creditor "retains a right to enjoy future appreciation in the collateral or to compensate for an initially low appraisal"). The section 1111(b) election, therefore, answers *Dewsnup*'s concern about undersecured creditors' access to appreciation, but only in chapter 11 cases. In the absence of the election, stripdown is as permissible in chapter 11 cases as it is elsewhere.

Although the section 1111(b) election appears beneficial to creditors, it does not actually require that the debtor pay more in terms of economic value than the collateral's worth. If payments extend for a sufficient period of time, the present value of payments having a face amount equal to the debt ($25,000, in the example) can, in fact, be made to equal the value of the collateral ($10,000). Assume, for purposes of illustration, that our debtor proposes to pay the creditor interest only, annually, at the rate of 10% for 15 years, with a balloon payment of $10,000 at the end of that time. If 10% is an appropriate rate, the stream of payments will have a face amount of $25,000 ($1,000 per year for 15 years,

plus a balloon of $10,000), but a present value of only $10,000.

Three points are evident. First, Congress knew how to address concerns about appreciation when it had them. Second, stripdown is entirely permissible when the election either is not made or is unavailable. Third, even when at its creditor-protective best, Congress did not mandate that the undersecured creditor receive more than the economic value of its interest in collateral, even when its claim has some monetary value. When it does not—when the claim "is of inconsequential value"—the election is unavailable. § 1111(b)-(1)(B)(i). Petitioner would have this Court exceed what Congress was willing to do when treating undersecured creditors most favorably (and import it into chapter 7 as well).

Dewsnup's concern with postpetition appreciation was entirely misplaced. Every undersecured creditor is fully protected by proper valuation, made at the appropriate time, and by the opportunity to reinvest in the rising market. Congress required no more than that.

2. *Dewsnup* erroneously believed that liens pass through bankruptcy unaffected.

Dewsnup believed that the rule under pre-Code law—"liens pass through bankruptcy unaffected"—survived passage of the Code. *Dewsnup*

cited two recent cases[6] as well as the venerable decision of *Long v. Bullard*, 117 U.S. 617 (1886). *Dewsnup*, at 417. In so doing, *Dewsnup* grossly mischaracterized all three cases.[7]

In *Long v. Bullard*, a mortgage holder who had not participated in bankruptcy sought to enforce his lien against the debtor's exempt residence after the case closed. The issue in *Long* was whether discharge in bankruptcy eliminates only a creditor's

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[6] *Dewsnup* cited *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), and *Johnson v. Home State Bank*, 501 U.S. 78 (1991), each of which cited *Long*.

[7] The issue in *Farrey* was whether a lien, granted pursuant to a divorce decree that extinguished the parties' prior interests, is avoidable under section 522(f). The Court held no, citing *Long* for the slightly different, "particular" proposition that valid liens can be enforced against exempt property. 500 U.S. at 297. It is not at all evident that *Farrey* cited *Long* for the general rule, stated in *Farrey*'s prior sentence, that liens "ordinarily" survive bankruptcy. In any event, *Farrey* did involve lien avoidance, but in the context of deciding what liens fall within statutory language entirely unlike section 506(d).

In *Johnson*, the Court foreshadowed *Dewsnup*'s error by citing *Long* for the bare proposition that liens pass through bankruptcy. 501 U.S. at 84.

Some of the language in *Johnson* suggests that chapter 7 does not affect a creditor's nonbankruptcy right to enforce its lien. See *id.* ("[B]ankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*."). Reading *Johnson* in that way, however, requires taking its language out of context. The issue in *Johnson* was whether a *valid* lien that survives chapter 7 constitutes a "claim" in a subsequent chapter 13, and the Court decided in the affirmative. *Johnson* did not involve bankruptcy's power to avoid liens.

recourse against the debtor or recourse against the collateral as well. *Long* held that discharge only affects a debtor's personal liability and does "not relieve the property from the operation of liens created by contract before the bankruptcy." 117 U.S. at 620. *Long* addressed the effect of discharge, and its holding remains valid—discharge only affects a debtor's personal liability. See § 522(c) (providing that exempt property remains liable for debts secured by unavoided liens); § 524(a)(1) (providing that discharge affects only "the personal liability of the debtor").

Long dealt with the scope of discharge; it did not present a question of lien avoidance. Rather, *Long* presumed the validity of the lien at issue. To cite *Long* for the proposition that "liens pass through bankruptcy" is to perpetuate a deeply misleading half-truth. Accurately stated, *Long* stands for the proposition—unremarkable today—that valid liens are enforceable postbankruptcy. *Long* does not support the proposition that liens could not be reduced under pre-Code law for reasons other than payment of the full debt. *Long* says nothing about bankruptcy's power to avoid liens, then or now.[8]

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[8] Under pre-Code law, *valid* liens were unaffected by bankruptcy. Section 67(d) of the 1898 Bankruptcy Act said so expressly until amended by the Chandler Act in 1938. Pub. L. No. 55-541, 30 Stat. 544, *amended by* Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978). Thereafter, courts understood that no change in the law was intended. See *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (2d Cir. 1949) ("It has always been a fundamental principle of the bankruptcy law that the property rights and interests designated as liens and pledges, *when valid in bankruptcy*, shall not be impaired in the administration of a bankrupt estate. The Chandler Act manifests no intent to

3. *Dewsnup* misread *Radford* and the line of cases to which it belongs.

Dewsnup cited *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), to suggest that stripping a lien down to its supporting value raises constitutional concerns. By citing only *Radford* and failing to note subsequent cases, *Dewsnup* gave a misleading impression of this Court's holdings relevant to bankruptcy's treatment of secured claims. *Dewsnup* also mischaracterized *Radford* as a lien-stripping case when, in fact, that case presented a takings question.

Radford interpreted the Frazier-Lemke Act, Pub. L. No. 73-486, 48 Stat. 1289 (1934), which was designed to provide relief to farmers—a group especially hurt by the Great Depression. *Dewsnup* correctly noted that the Act's "avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property." *Dewsnup*, at 419 (quoting *Radford*, at 594). That was only a partial statement of the Act's effects, however. It did much more. It effectively allowed the debtor to purchase property, free of liens predating the Act, at appraised value—*i.e.*, an amount less than the debt—by making payments

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deviate from that principle." (emphasis added)). *Dewsnup* cited *Oppenheimer*, 502 U.S. at 418 n.4, oblivious that the adage—"liens pass through bankruptcy"—applies only to liens not avoided in the bankruptcy case. Nor did *Dewsnup* acknowledge the bankruptcy sea-change made by the Code. See *infra*, pp. 20-26.

over time, without interest. This, according to *Radford*, amounted to a retroactive taking of the mortgagee's property without just compensation.

Congress amended the Frazier-Lemke Act almost immediately after *Radford*. Pub. L. No. 74-384, 49 Stat. 942 (1936). This Court found the revised Act to pass constitutional muster in a series of cases: *Wright v. Vinton Branch Bank*, 300 U.S. 440 (1937) (*Wright I*); *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502 (1938) (*Wright II*); and *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940) (*Wright III*). These cases unquestionably limited *Radford*.

In *Wright I*, the Court identified retroactivity as the constitutional infirmity of the original Frazier-Lemke Act:

> The decision in the *Radford* case did not question the power of Congress to offer to distressed farmers the aid of a means of rehabilitation under the bankruptcy clause. The original Frazier-Lemke Act was there held invalid solely on the ground that the bankruptcy power of Congress, like its other great powers, is subject to the Fifth Amendment; and that, as applied to mortgages given before its enactment, the statute violated that Amendment, since it effected a substantial impairment of the mortgagee's security.

300 U.S. at 456-57.[9] And in *Wright III*, the Court held that a bankruptcy statute permitting the debtor to purchase encumbered property by paying its current value does not violate constitutionally-protected rights of the mortgagee: "Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property. . . There is no constitutional claim of the creditor to more than that." 311 U.S. at 278.

Radford, taken alone, misstates this Court's constitutional holdings regarding secured claims. Under those holdings, a secured creditor, paid the present value of its collateral, has no sustainable constitutional complaint, notwithstanding *Dewsnup*'s intimations to the contrary. Congress read the *Radford-Wright* line of cases to require that a secured creditor receive every penny of the value available to support its claim, but no more. This constitutional mandate became bankruptcy's touchstone.

4. *Dewsnup* misunderstood the intent of Congress and structure of the Bankruptcy Code.

Plain text must control, unless "demonstrably at odds" with legislative intent. *U.S. v. Ron Pair Enterps. Inc.*, 489 U.S. 235, 241 (1989). Legislative history relevant to these cases, however, reveals that

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[9] Retroactivity remained a concern under the Code. In *United States v. Security Industrial Bank*, 459 U.S. 70 (1982), the Court held that section 522(f), which permits avoidance of certain liens impairing a debtor's exemptions, cannot be applied retroactively. The cases at bar involve no issue of retroactivity.

Congress meant exactly what the statute plainly says.

a. Congress adopted a "priority model" of secured creditors' rights in bankruptcy.

The Code provides that a lienholder, upon valuation of the collateral in accordance with bifurcation under section 506(a), is entitled either to its collateral or to the value of that collateral (again, with interest, if necessary). Congress, in effect, adopted a "priority" view[10] of the rights of secured creditors.[11] This model requires that the holder of a secured claim receive the value of supporting collateral; it does not permit creditors to assert rights to a specific piece of property.

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[10] Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy:* Dewsnup, Nobelman *and the Decline of Priority*, 25 ARIZ. ST. L.J. 547, 556 n.26 (1993) [hereinafter "Newborn, *Undersecured Creditors*"] ("Under a "priority" notion of security, "security" means a right not to a specific piece of collateral, but simply a right to be paid first to the extent of the value of the collateral.").

[11] See generally Newborn, *Undersecured Creditors*, at 578 ("Under the [1898] Act, security represented a concept closer to a right to a particular piece of collateral and the right to exercise nonbankruptcy collection rights . . The drafters of the Code promulgated an approach based upon priority." (footnote omitted)); Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234 (1997) [hereinafter "Ponoroff & Knippenberg"], at 2272-73 (noting that the Code adopted "the principle that the secured creditor's rights were limited to the value of its collateral rather than to a possessory interest in the collateral itself." (footnotes omitted)).

Congress codified the priority model consciously and intentionally:

> One of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, [the bill] distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are undersecured. Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

H.R. REP. NO. 595, 95th Cong., 1st Sess. 180-81 (1977) [hereinafter "H.R. REP. NO. 95-595"]. Commentators, then and later, understood that the Code had adopted a priority model in dealing with the rights of secured creditors in bankruptcy.[12]

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[12] See, e.g., Charles A. Shanor, *A New Deal For Secured Creditors in Bankruptcy*, 28 EMORY L.J. 587, 595 n.39 (1979) ("The Code's focus on the value of the secured party's claim

b. Congress intended to protect only the value of secured claims.

Never in the process of revision did Congress even hint that *in rem* rights are sacrosanct. Quite the opposite. Multiple sections of the Code are consistent with a priority view of secured creditors' rights.

The first of these is section 506(a) itself. Bifurcation became necessary when Congress chose to protect only the value of a secured claim. *Dewsnup* failed to realize that section 506(a) is definitional, intended to define the meaning of a "secured claim" throughout the Code, for all purposes:

> *Throughout the bill,* references to secured claims are only to the claim determined to be

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rather than on the security itself is a substantial change from both the Act and the U.C.C."); Peter F. Coogan, *Article 9—An Agenda for the Next Decade*, 87 YALE L.J. 1012, 1028-30 (1978) (indicating that then-new Bankruptcy Code viewed a secured party's interest as a prior claim against specific assets rather than as "property rights"); Douglas Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 113 (1984) ("A secured creditor's property right is limited in its scope by its purpose, which is to implement the secured creditor's priority right."); Eisenberg, *Undersecured Creditor*, at 952 ("This view translates secured status into a priority claim equal to the value of the creditor's collateral, which alone is the measure of the value of the creditor's secured status in bankruptcy.").

> secured under this subsection [section 506(a)], and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their places the terms "secured claim" and "unsecured claim."

H.R. REP. NO. 95-595, at 356 (emphasis added). Thus, wherever the phrase "secured claim" appears in the Code, it carries this post-bifurcation meaning (with a handful of statutory exceptions and the exception of section 506(d) as interpreted by *Dewsnup*).

Adherence to the mandate of the *Radford-Wright* line of cases—that a secured creditor receive the value of its secured claim—also necessitated that such claims be protected from erosion during the case. This function is served by section 361, which sets out a nonexclusive list of ways an otherwise-deteriorating secured claim can be maintained. Adequate protection can come from: cash payments, § 361(1); a lien on additional or different property, § 361(2); or anything else assuring that the creditor will receive the "indubitable equivalent" of the value of the collateral supporting its claim, § 361(3).

Section 361 clearly protects the creditor's right to the value of its collateral, but not any right to the property itself. Nowhere is a secured creditor given a right to insist upon *in rem* realization against its pre-bankruptcy collateral. Instead, such an entity is assured of receiving the value of its collateral, with-

out reduction by postpetition depreciation,[13] and nothing more. The House Report was quite specific on this point:

> The section [361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.
>
> The section specifies four means of providing adequate protection. They are neither exclusive nor exhaustive. They all rely, however, on the value of the protected entity's interest in the property involved.

H.R. REP. NO. 95-595, at 339.

This legislative history supports three interrelated propositions: first, the secured creditor is

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[13] Charles J. Tabb, BANKRUPTCY 294 (3d ed. 2014) (stating that section 361 protects creditors from a decrease in value of their interests "caused by the imposition of the bankruptcy case, during the pendency of the case").

entitled to the value of its collateral as a matter of constitutional right;[14] second, this value is to be protected from erosion during the case; and third, what Congress meant by "the benefit of the bargain" is that the undersecured creditor can claim the value of its position, not the collateral itself.

In the face of sweeping change, legislative itemization is too much to expect. See, e.g., *U.S. v. Ron Pair Enters.*, 489 U.S. 235, 240-41 (1989) ("In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took."). Here, however, we have particularity. This legislative history refutes one of *Dewsnup*'s major rationales—namely, that Congress must not have meant to change pre-Code treatment of undersecured creditors because the legislative history makes no such mention. In fact, legislative history indicates Congress's intent to bring undersecured creditors within bankruptcy's reach to a significant degree, and for the first time.[15] Contrary to prior

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[14] The legislative history cited both *Radford* and *Wright III*: H.R. REP. NO. 95-595, at 339 ("The concept [of adequate protection] is derived from the fifth amendment protection of property interests as enunciated by the Supreme Court. See *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).").

[15] Commentators so understood at the time the Code was enacted. See Frank R. Kennedy, *Secured Creditors Under the Bankruptcy Reform Act*, 15 IND. L. REV. 477, 486-87 (1982) ("The Bankruptcy Reform Act is more explicit in regard to the rights of secured creditors than any previous bankruptcy legislation.").

practice, a court can now deny an undersecured creditor access to its collateral, provided that the creditor receive adequate protection for the value of its interest. This development fits hand in glove with a jurisprudence of bifurcation.

c. The Code's structure is consistent with a priority understanding of secured creditors' rights.

Other provisions, found across the Code, consistently use "secured claim" to mean the post-bifurcation amount, as determined under section 506(a). These provisions are also consistent with the priority view, replacing a secured creditor's rights against collateral with assurance that the creditor will receive the value of those rights.

First, section 364(d) authorizes a court to trump an existing secured claim by imposing a new lien having equal or even senior priority. This is an extraordinary power, exercisable only when necessary postpetition credit cannot be obtained in a less intrusive manner. The demoted creditor can look only to section 361 for adequate protection, however; it cannot appeal to its *in rem* rights under state law. Thus, under sections 361 and 364, the secured creditor's rights are not tied to access to specific collateral.

Second, section 722 permits an individual debtor to redeem consumer personalty "by paying the amount of the allowed secured claim . . . in full, at the time of redemption." The creditor cannot insist on retaining its lien until the debt is satisfied,

although that is exactly what state law requires. Congress was aware that this section gives debtors broader rights than state law provides. See H.R. REP. NO. 95-595, at 380 ("This section [722] is new and is broader than rights of redemption under the Uniform Commercial Code."). Congress here reiterated that the creditor's bargain extends only to the value of available collateral, noting that section 722 "does not prevent the creditor from obtaining what he is entitled to under the terms of his contract." *Id.*

Third, section 506(b), which gives an over-secured creditor rights to postpetition interest, extends only to the value of the collateral. 4 COLLIER ON BANKRUPTCY ¶ 506.04[1], at p. 506–95 (16th ed. 2014) ("For purposes of section 506(b), an 'allowed secured claim' is an allowed claim that qualifies as a secured claim as provided under section 506(a)."). Once that value is consumed, no more postpetition interest can be added to the claim. *Id.* at ¶ 506.049[2], at p. 506–98.

Finally, plan confirmation provisions under the reorganization chapters require payment of no more than the present value of the secured claim. Chapters 12 and 13 provide that the nonconsenting holder of an "allowed secured claim" retain its lien and receive property with a present value of "the allowed amount of such claim." § 1225(a)(5)(B); § 1325(a)(5)(B)(ii). The requirements for chapter 11 are similar, although with more complicated wording. See *supra*, p. 11-14. Under each of these provisions, nonconsenting secured creditors generally must receive a stream of payments with a

face amount and present value equal to the amount of the claim. That assures an undersecured creditor the value of the collateral, with interest when necessary.

In all of these provisions, the Bankruptcy Code is consistent with a priority view of secured creditors' rights, entitling them to the *value* of the collateral supporting their liens, no more and no less.

This is not to say that Congress intended no exceptions. When exceptions appear, however, they are clearly drawn. They also cut both ways, sometimes allowing elimination of liens fully supported by value and occasionally providing more generous treatment to an undersecured creditor.

Exceptions in the former category permit avoidance of liens with economic value—that is, "secured claims," as defined by section 506(a). Examples include: section 547, permitting avoidance of liens arising shortly before bankruptcy, when given to secure pre-existing debts; section 548, allowing avoidance of certain transfers and obligations on the grounds of constructive fraud, evidenced by the debtor's having made a transfer or incurred an obligation for less than reasonably equivalent value within two years before bankruptcy; section 545, permitting avoidance of designated statutory liens; and section 522(f)(1), enabling the debtor to avoid judicial liens, as well as nonpossessory, nonpurchase money security interests in

specified categories of property, if those encumbrances impair the debtor's exemptions.[16]

Exceptions in the latter category use targeted language to extend additional rights and protections to holders of particular secured claims. One such provision, section 1111(b), has already been discussed. See *supra*, p. 11-14. Another—section 1322(b)(2), as interpreted by this Court in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993)—protects the rights of creditors holding claims secured by the debtor's residence. *Nobelman* interpreted section 1322(b)(2) to prevent stripdown of the undersecured creditor's lien, effectively reading section 1322(b)(2) as an exception to the otherwise-applicable rule of sections 506(a) and (d). That decision rested on the statute's reference to "rights" rather than "claims."

More recently, Congress added protections for undersecured creditors whose interest in the debtor's automobile arose within 910 days of bankruptcy, and for undersecured creditors who took an interest in "any other thing of value" within a year before bankruptcy. § 1325(a)(*) (*added by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 306(b), 119 Stat. 80-81). In

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[16] In these instances, bankruptcy voids liens *with* supporting value, and does so with no constitutional taint whatsoever. Cf. James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 1031 (1983) ("The only significant constitutional restraint on the substance of purely prospective bankruptcy legislation is the bankruptcy clause itself.").

order to create this additional protection, Congress was very careful to render section 506 inapplicable, stating that "section 506 shall not apply" in those fact patterns. This provision (known as the "hanging paragraph") prevents bifurcation of an undersecured claim in chapter 13 cases—the very effect *Dewsnup* achieved in the absence of clear language such as that added in 2005, and for all undersecured creditors in chapter 7 cases.

Also in 2005, Congress added a requirement in chapter 13 that a lien remain in place until full repayment of the debt or the debtor's discharge. § 1325(a)(5)(B)(i)(I). That enables an undersecured creditor to retain its lien until the debt has been repaid, when the debtor is ineligible for discharge. See *Colbourne v. Ocwen (In re Colbourne)*, 550 Fed. Appx. 687 (11th Cir. 2013).

When Congress wanted to protect an undersecured claim from stripdown, it expressly provided exceptions to the otherwise-applicable rules of sections 506(a) and (d). Some of these provisions apply only in reorganization proceedings, some only in liquidations, and others only in cases concerning individual debtors. But nothing in the legislative history, or the structure of the Code itself, suggests that the fundamental rights of secured creditors depend on whether the bankruptcy proceeding at issue is a reorganization or a liquidation.

d. *Dewsnup* erroneously believed that Congress followed pre-Code rules, permitting stripdown only in reorganization cases.

The *Dewsnup* Court pointed to pre-Code law permitting stripdown only in reorganization cases, and concluded that "Congress must have enacted the Code with a full understanding of this practice." *Dewsnup*, at 419. That is true, but Congress's "full understanding" cut entirely the other way.

First, Congress intended to make "significant changes from current law in . . . the treatment of secured creditors and secured claims," H.R. REP. NO. 95-595, at 180, as described above. See *supra*, pp. 19-30. Reliance on pre-Code law is particularly perilous given the wholesale rewriting of bankruptcy law in 1978.

Second, Congress intended the Code to repair the inefficacy with which pre-Code law handled consumer cases: "The current Bankruptcy Act, last revised in any major way in 1938, was not designed to provide adequate relief to the consumer debtor. The primary thrust of the 1938 revision was toward business bankruptcies, because consumer bankruptcy was not a significant factor in the 1930's." H.R. REP. NO. 95-595, at 116-17. Congress did not address these deficiencies by drawing distinctions between business and consumer cases, however. The bill made "no such distinction." *Id.* at 6. Instead, "provisions of chapter 7 . . . apply equally to business and consumer cases" and "provisions in the generally applicable chapters, 1, 3, and 5, are not divided along consumer/business lines." *Id.* When rules need to apply differently in consumer and business cases—or, one might add, in liquidation and reorganization cases—the Code says so expressly. Otherwise,

generally applicable provisions, such as sections 506(a) and (d), apply across the universe of bankruptcy cases.

Dewsnup rests ultimately on a belief that the fundamental rights of secured creditors are different, depending upon whether the debtor is in a liquidation or reorganization proceeding. Although pre-Code law focused on reorganizations, the Code adopted rules that apply across all bankruptcies. Thus, *Dewsnup* completely misread the purposes of Congress, as expressed in the statute and its legislative history. Unless the Code says otherwise, it protects a secured creditor's interest only to the extent of the value of available collateral, and it draws no distinction between rules generally applicable to liquidations and those applicable to reorganizations.

II. Even if *Dewsup* is not overruled, it should not be extended to liens wholly underwater.

Even if this Court is unwilling to overrule *Dewsnup*, despite the poverty of its statutory reading and supporting rationale, *Dewsnup* should not be extended to protect liens wholly devoid of value.

A. The Code, as interpreted by *Dewsnup*, does not protect liens devoid of supporting value.

The Code provides a basis for confining *Dewsnup* to the realm of chapter 7 claims supported by

some modicum of value.[17] *Dewsnup* read each of the terms in section 506(d)—"allowed," "secured" and "claim"—independently, and concluded that a claim cannot be stripped down, in a chapter 7 case, as long as it meets all three requirements. The Court found the definitions of "allowed" and "claim" in the Code, in sections 502 and 101(5) respectively. The definition of "secured" must be found there as well, and the only possibility is section 506(a). Under its express language, no claim can be secured in the absence of some amount of supporting value, and *Dewsnup* rested on the existence of a secured claim in the first place.

Post-*Dewsnup*, this Court has looked to section 506(a) as the starting point. In *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), the Court stated that the debtors "were correct in looking to section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim." *Id.* at 328. This implicitly acknowledges that, in the absence of supporting value, there can be no "secured" claim for purposes of *Dewsnup*'s protection. The mortgages held by petitioner do not qualify.

That Congress intended no protection for a valueless lien is made express in section 361, which requires adequate protection only to the extent of an "entity's interest" in property.[18] The legislative

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[17] So, too, does *Dewsnup* itself. *Dewsnup*, at 417 ("We . . . focus upon the case before us and allow other facts to await their legal resolution on another day.").

[18] Congress was specific when it wanted a different result in chapter 12. See § 1205 (prohibiting, in chapter 12 cases, a

history is even clearer, stating that all of the methods of providing adequate protection "rely . . . on the value of the protected entity's interest in the property involved." H.R. REP. NO. 95-595, at 339. Since the creditor's "interest" is to be protected under section 361 against a decline in value, adequate protection is not required when a lien is already valueless. This Court recognized decades ago, in a case involving similar statutory provisions, that valueless liens have no position to protect. In *In re 620 Church Street Building Corp.*, 299 U.S. 24 (1936), holders of valueless liens (citing *Radford*) protested the plan's failure to provide them a distribution:

> Petitioners insist that . . . their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court as having "no value." There was no value to be protected. This finding embraces whatever interests petitioners may have as junior lienors under the Illinois law and, in the same aspect, the constitutional argument is unavailing as petitioners have not shown injury.

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grant of "the indubitable equivalent of [an] entity's interest" pursuant to section 361(3)).

Id. at 27. The Bankruptcy Code, following pre-Code law, expressly provides no protection for petitioner's valueless liens.

B. Extending *Dewsnup* to protect liens devoid of supporting value would have negative inter-creditor effects, and give lienholders inappropriate leverage against debtors and other creditors.

Dewsnup focused on the relationship between the debtor and one creditor, and sought to prevent a windfall for the debtor at the expense of that creditor. Debtors enjoy no "windfall" by virtue of stripdown even when a lien is partially secured, *Dewsnup* to the contrary notwithstanding. See *supra*, pp. 8-11. When liens are without any value, however, extending *Dewsnup* to prevent stripoff of the valueless lien would create negative inter-creditor effects.

A junior creditor retaining a valueless lien can compel a post-bankruptcy foreclosure that will produce not one dime for the moving creditor. If the junior creditor does not buy the property, the senior creditor will bid in its debt, leaving nothing for the junior lienholder and simultaneously accomplishing what *Dewsnup* prohibited—elimination of the subordinate lien. See Baxter Dunaway, 2 LAW OF DISTRESSED REAL ESTATE § 26:23 (2014), *available at* Westlaw LAWDRE ("When a senior lender forecloses, the junior lender's lien is in danger of being eliminated or 'sold-out' if there is no surplus from the sale by the senior."). If the junior creditor

does desire to purchase the property at foreclosure, however, it cannot merely bid in its debt; rather, the junior creditor will have to put real money on the table, in an amount sufficient to satisfy the first mortgage. *Id.* It strains credulity to believe that a junior lienholder, already deeply underwater, would extend its losses in that way.

Any plea for a right to capture appreciation in such cases is an empty shibboleth. Taking the steps required for ownership—necessary in order to reach appreciation, but economically irrational—would alone produce no return. Appreciation even in an amount equal to the total of both debts—an astronomical improvement—would accomplish nothing other than elimination of loss; the junior creditor would still have no gain. And, as discussed above, *supra*, p. 10-11, regulatory rules and statutes may not permit the creditor to hold the property and hope.

Retention of a valueless lien does have one reasonable possible use, however—as leverage, to extract value from the debtor as the price for releasing the lien. The creditor with skin in the game is the holder of the first mortgage. That creditor may choose, for its own reasons, to allow the debtor to retain residential property in exchange for reaffirmation of the debt. But that strategy requires the junior lienholder to release its lien. That lien, devoid of economic value, now has leverage value.

Nothing is served by structuring such a consequence. Legitimate business interests of a creditor with money at stake, who prefers reaffirmation to

foreclosure, should not be upended by a creditor who could not realize even a nickel by pursuing its state law rights. This would produce in bankruptcy an outcome markedly different from the outcome under state law, contravening this Court's repeated admonitions and putting a windfall, now real, in the other pocket. See *Patterson v. Shumate*, 504 U.S. 753, 764 (1992) (noting that enforcing in bankruptcy statutes applicable outside, "minimizes the possibility that creditors will engage in strategic manipulation of the bankruptcy laws in order to gain access to otherwise inaccessible funds").

Nor is bankruptcy policy advanced by putting such leverage in the hands of a creditor with no economic stake in the very lien it so assiduously attempts to retain. In two other contexts, Congress identified the exercise of such leverage as an abuse bankruptcy should prohibit, and enacted provisions designed to do just that: section 522(f), allowing the debtor to avoid nonpossessory, nonpurchase money security interests on designated categories of property; and section 722, discussed *supra*, pp. 26-27. Congress sought to counter creditors' efforts to compel repayment by threatening to repossess items with minimal value in the creditor's hands, but high replacement costs. See H.R. REP. NO. 95–595. at 127. Successful use of such leverage would also violate bankruptcy policy by overcompensating the creditor, enabling a greater return than that attainable under nonbankruptcy law.

CONCLUSION

Providing debtors a "fresh start" is not a mere slogan; it is consumer bankruptcy's defining principle. See H.R. REP. NO. 95-595, at 114 ("[A] fresh start for the debtor . . . is the essence of modern bankruptcy law"); *id.* at 118 ("[B]ankruptcy relief should be effective, and should provide the debtor with a fresh start."). So, too, is bankruptcy's design to protect the value of a secured creditor's rights, but not the rights themselves.

Petitioner wants to preserve a right to foreclose despite the lack of return, even upon resale at arms' length in a retail market.[19] Since petitioner is almost certainly going to receive exactly the same amount from these liens, whichever way this case is decided, one should wonder what is really going on. Whatever it is, for petitioner it is not about realizing any value from these mortgages.

Much is made of the "bargain" here, Brief for Petitioner at 22, 26, 28, but agreements have two sides. Petitioner would have us believe that these debtors agreed to a bargain that, despite bankruptcy's protections, will cost them their homes although it profits this bank nothing.

This Court should affirm the decisions below, and overrule *Dewsnup* in the process.

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[19] One might wonder, as did the Court in *United Savings Association v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 375 (1988), "why Congress would want to provide relief for such an obstreperous and thoroughly unharmed creditor." Here, as there, Congress did not.

Respectfully submitted,

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In the Supreme Court of the United States

BANK OF AMERICA, N.A.,

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v.

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF JEROME N. FRANK LEGAL SERVICES ORGANIZATION AND CONNECTICUT FAIR HOUSING CENTER AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE[1]

The Jerome N. Frank Legal Services Organization at the Yale Law School ("LSO") is a legal clinic in which law students, supervised by faculty attorneys, provide legal assistance to individuals who cannot afford private counsel. The Mortgage Foreclosure Litigation Clinic (the "Clinic"), part of LSO, has been representing homeowners fighting foreclosure in Connecticut since 2008. In that capacity, the Clinic has appeared in state and federal court proceedings at both the trial and appellate levels, and filed amici briefs with appellate courts in North Carolina, California, and Maine. LSO and its clients also have testified before the Connecticut legislature on foreclosure policy. The students of the LSO are the primary authors of this brief. This brief does not reflect the views of the Yale Law School.

The Connecticut Fair Housing Center ("CFHC") is a nonprofit law office based in Hartford, Connecticut. The Center represents dozens of homeowners in state and federal court, provides individualized advice and in-person foreclosure-related guidance to more than 1800 homeowners each year, and trains and advises hundreds of attorneys, housing counselors, and government employees who work with homeowners facing foreclosure. In addition, the Center works with Congress and the Executive Branch,

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[1] Pursuant to Supreme Court Rule 37.6, this brief was not authored, in whole or in part, by counsel for a party. No person other than the amici and their counsel made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

along with all three branches of Connecticut's government, to devise and implement policies that ameliorate the foreclosure crisis and reduce problematic mortgage lending and servicing practices.

CFHC and LSO have an interest in this case because the treatment of junior mortgages in bankruptcy has a crucial impact on outcomes for troubled borrowers and on the health of the housing market overall. Through our organizations' work with homeowners confronting foreclosure, we have been able to observe the distinct role of junior mortgages. We have witnessed the unique challenges junior mortgages create for lenders and borrowers who wish to restructure a purchase-money residential mortgage, as well as for industry and governmental stakeholders that bear the burden of unnecessary foreclosures.

SUMMARY OF ARGUMENT

The Bankruptcy Code reflects two general purposes. First, it seeks to provide debtors with a fresh start. Second, it seeks to preserve assets and efficiently resolve debts for the benefit of creditors and society as a whole. The Bankruptcy Code thereby helps maintain a healthy housing market.

Allowing fully underwater junior mortgages to escape the Section 506(d) lien-voiding provision undermines these essential purposes. Because junior mortgages do not promote a healthy housing market, they do not merit special protections in bankruptcy. Recognizing these concerns, both federal and state programs treated junior mortgages significantly worse than first mortgages in their responses to the unhealthy housing markets of the mid-2000s.

When a second mortgage is entirely underwater, the second mortgagee, by definition, has no legitimate economic stake in the debtor's home. Holders of underwater junior mortgages have incentives to engage in inefficient behavior to extract undeserved side-payments. In doing so, junior mortgagees exhibit the hold-up behavior that bankruptcy seeks to combat.

Allowing lien voiding of fully underwater junior mortgages will not open the floodgates to mass bankruptcy filings because bankruptcy imposes long-lasting costs on the debtor. Nor would allowing such voiding hurt the housing markets. To the contrary, voiding underwater junior liens provides benefits to homeowners, first mortgagees, the housing market, and society as a whole.

ARGUMENT

I. The Role Of Junior Mortgages In The Housing Market Justifies Voiding Junior Liens In Bankruptcy

A. Generally, The Bankruptcy Code Helps Maintain A Healthy Housing Market

Congress's policy goal of maintaining a healthy economy animates the general purposes of the Bankruptcy Code. These general purposes are twofold. First, bankruptcy offers debtors the possibility of a "fresh start." *See, e.g.*, *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fid. & Guar. Co.*, 236 U.S. 549, 554-55 (1915)) ("One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh '"). To that effect, a number of provisions in the Bankruptcy Code allow a debtor to discharge certain debts and void certain liens. The most important such provision for this case is Section 506(d), which voids a lien "[t]o the extent that [it] secures a claim against the debtor that is not an allowed secured claim." 11 U.S.C. § 506(d).

Second, bankruptcy preserves assets and allocates them efficiently for the benefit of all creditors. *See, e.g.*, *Corporate Assets, Inc. v. Paloian*, 368 F.3d 761, 767 (7th Cir. 2004) ("A central purpose of bankruptcy is to maximize creditor recovery."). To do so, bankruptcy prevents any one creditor from acting unilaterally to obstruct an efficient resolution of debts. The Bankruptcy Code thereby mitigates collective action problems among creditors that would otherwise result in distortive, inefficient behavior by

certain creditors at the expense of other creditors and society as a whole.

By giving debtors a fresh start while efficiently allocating assets to creditors, the Bankruptcy Code helps restore a market to health. Every provision in the Bankruptcy Code must be read in light of Congress's underlying goal of promoting healthy markets. In particular, when a lien-voiding rule—like Section 506(d)—helps give a debtor a fresh start, there is no reason to deviate from that rule where such deviation has little, or a negative, impact on the housing market. In such cases, any desire to deviate should yield to the Bankruptcy Code's general purpose of giving debtors a fresh start.

B. Protecting Junior Liens In Bankruptcy Does Not Promote Healthy Housing And Lending Markets

A prohibition on junior lien voiding interferes with healthy housing and lending markets. The Bankruptcy Code's general purpose of giving debtors a fresh start therefore applies in full force, and a deviation from Section 506(d)'s general command to void unsecured liens is unjustified.

Market analysis demonstrates that the Bankruptcy Code should distinguish between first and junior mortgages in the lien-voiding context. First mortgages help people purchase homes, and play a vital role in maintaining a healthy housing market. Junior mortgages, on the other hand, generally facilitate personal spending. As such, junior mortgages resemble personal debt and do not play a critical role in a healthy housing market. Moreover, junior mortgages that actually facilitated home purchases con-

tributed to *unhealthy* housing and lending markets in the lead-up to the 2008 financial crisis.

By portraying first mortgages and junior mortgages as differing only in priority, Petitioner ignores these market realities. Of course, first and junior mortgages do differ in priority; in the event of a foreclosure, the debt owed to the first mortgagee must be satisfied before any junior mortgagees can recover. *See Restatement (Third) of Property: Mortgages* §§ 7.1, 7.4 (1997). If the first mortgage is underwater—as Respondents' are in this case—then the second mortgage has no equity value. Priority, however, is not the only difference between first and junior mortgages. In today's marketplace, a first mortgage is a tool for gaining homeownership; a junior mortgage endangers it.

1. First Mortgages Help People Purchase Homes, Whereas Junior Mortgages Facilitate Personal Spending

First mortgages have long played a critical role in maintaining a healthy housing market. By allowing those who are not affluent to acquire a home through leverage, first mortgages have fueled investment in the housing market. And by allowing homeowners to enjoy the gains from rising home prices while paying down principal, first mortgages have contributed substantially to household wealth. The family home, bought with the help of a first mortgage, is a classic symbol of the "American Dream." Even after the financial crisis, homeownership and the mortgages that make them possible remain prevalent: in 2013, 65.2% of families owned their home, and 41.0% of families had a first mortgage. *Changes in U.S. Family Finances from 2010 to*

2013: Evidence from the Survey of Consumer Finances, Fed. Res. Bull., Sept. 2014, at 22, 34 n.44, available at http://www.federalreserve.gov/pubs/bulletin/2014/pdf/scf14.pdf. American families also have substantial wealth invested in their homes; the sum of the fair market values of all homes exceeds $20 trillion, securing $8.7 trillion in first mortgage debt (excluding first-lien home equity lines of credit, discussed below). Bd. of Governors, *Financial Accounts of the United States, Third Quarter 2014*, Fed. Res. Sys. 107, 117 (Dec. 11, 2014), available at http://www.federalreserve.gov/releases/z1/current/z1.pdf (hereinafter *Financial Accounts of the United States*).

Roughly 60% of first mortgages currently in existence were originated at the time of purchase; an additional 37% have been refinanced. *See American Housing Survey for the United States: 2011*, U.S. Census Bureau 79-80 (Sept. 2013), available at http://www.census.gov/content/dam/Census/programs-surveys/ahs/data/2011/h150-11.pdf (hereinafter *American Housing Survey*). Most of those who have refinanced their first mortgage—77%—did so in order to get a lower interest rate. *Id.* at 80. Only 14% have done so in order to obtain cash, *id.*, and in a healthy housing market, the actual value of equity converted to cash in these refinances is trivial. Indeed, while cash-out refinances became very popular in the mid-2000s, they do not play nearly as important a role today. According to Freddie Mac, homeowners who refinanced their first mortgage in the fourth quarter of 2014 cashed out only $6.7 billion—barely 0.06% of total home equity. Office of the Chief Economist, *2014 Fourth Quarter & Full Year Refinance Report*, Freddie Mac (Feb. 4, 2014), avail-

able at http://www.freddiemac.com/finance/pdf/RefiReport2014Q4.pdf; *Financial Accounts of the United States*, *supra*, at 117. The vast majority of refinanced first mortgages, then, as well as all first mortgages originated at the time of purchase, have the same basic purpose: to help people purchase and retain their homes.

Property law also recognizes the critical role of first mortgages in the housing market. Purchase-money mortgages (those used to purchase real property) usually have priority over all other liens, even those arising prior to the purchase. *See generally Restatement (Third) of Property: Mortgages* § 7.2 (collecting cases and statutes supporting this rule). Therefore, a mortgage that helps a family purchase a home will generally be defined as a first mortgage regardless of when it was actually originated. By the numbers and by legal definition, then, first mortgages primarily serve the purpose of promoting homeownership.

Junior mortgages, on the other hand, are taken out for purposes besides acquiring a home. Most junior mortgages are taken out to facilitate some form of personal spending: to consolidate debts (especially credit card debt, itself usually a vehicle for personal spending); to finance a child's college education; to pay for a large non-real estate purchase (e.g., a car, boat, or vacation); or simply to open up a line of credit and increase liquidity. Some junior mortgages also facilitate home improvement.

There are two common types of junior mortgages: open-end home equity lines of credit ("HELOCs"), which allow homeowners to borrow up to a certain credit limit against their equity, and closed-end,

lump-sum mortgages. A HELOC is a revolving line of credit that operates "much like a credit card," and usually funds a wide range of personal spending. *See Home Equity Loans and Credit Lines*, Fed. Trade Comm'n (Aug. 2012), available at http://www.consumer.ftc.gov/articles/0227-home-equity-loans-and-credit-lines. A 2007 Federal Reserve Board working paper collected data showing that about a third of HELOC funds are used for personal consumption (including "education, automobiles, medical and dental expenses, weddings, and vacations"); a third for consolidation of non-mortgage debt (often credit card debt); and a third for home improvement. Alan Greenspan & James Kennedy, *Sources and Uses of Equity Extracted from Homes* 40 (Fed. Reserve Bd. Fin. & Econ. Discussion Series, Working Paper No. 2007-20, 2007), available at http://www.federalreserve.gov/pubs/feds/2007/200720/200720pap.pdf. Few HELOCs are originated at the time of purchase; Respondent Edelmiro Toledo-Cardona's is no exception. Pet'r's Br. 5.

Classic home equity loans—garden variety closed-end junior mortgages—also usually fund personal spending. About half of the proceeds from home equity loans go to consolidation of non-mortgage debt, a quarter to home improvement, and a fifth to personal consumption. Greenspan & Kennedy, *supra*, at 8. These debt-consolidating, cash-out home equity loans essentially function like cash advances on credit cards. Like credit cards, then, HELOCs and home equity loans facilitate various forms of personal spending, and seldom fund home purchases.

The practice of taking out "piggyback" second mortgages in order to acquire property contributed to unhealthy housing and lending markets in the mid-2000s, but has since almost disappeared. In the lead-up to the 2008 financial crisis, many homeowners—including Respondent David Caulkett—were given piggyback second mortgages to cover what would otherwise be a down payment or a mortgage insurance premium.[2] These piggyback second mortgages increased loan-to-value ratios ("LTVs") while creating additional profits for the brokers and loan officers who sold them. As a consequence, the housing bubble grew. *See* Br. Amicus Curiae Adam J. Levitin Part I.A. And when the bubble burst, home prices plummeted, causing many second mortgages—including Respondents'—to become completely unsecured.

The role played by these piggyback mortgages was an historical aberration. The percentage of first mortgages burdened with a piggyback second mortgage rose from 2.1% in 2000 to 21.4% in 2006, but dropped back down to 3.5% in 2012. Andrew Leventis, *The Relationship Between Second Liens, First Mortgage Outcomes, and Borrower Credit: 1996-*

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[2] Traditionally, a home purchaser puts down 20% of the purchase price in a down payment. The LTV on a home with a 20% down payment is initially 80%. Making a 20% down payment ensures that the homeowner has some equity, at least initially, thus decreasing the risk of going underwater. *See* Dov Solomon & Odelia Minnes, *Non-Recourse, No Down Payment and the Mortgage Meltdown: Lessons from Undercapitalization*, 16 Fordham J. Corp. & Fin. L. 529, 541 (2011). Reflecting the greater risk of foreclosure on homes with high LTVs, homeowners who do not make a 20% down payment often must pay monthly mortgage insurance premiums. Leventis, *supra*, at 3.

2010, at 11 (Fed. Hous. Fin. Agency, Working Paper No. 14-3, 2014), available at http://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/WP_14-3_Second_Liens.pdf. In 2013, as the housing market began to recover, financial institutions covered by the Home Mortgage Disclosure Act (HMDA), 12 U.S.C. §§ 2801-2810, reported $3.6 billion in junior mortgages originated for the purpose of home purchase, compared to $1.1 *trillion* in first mortgages for that purpose. *Home Mortgage Disclosure Act: Explore the Data*, Consumer Fin. Protection Board, available at http://www.consumerfinance.gov/hmda/explore (accessed Feb. 16, 2015). Generally, around 5% of HELOCs and 7% of closed-end junior mortgages facilitate the purchase of real property—including vacation homes and investment properties. Greenspan & Kennedy, *supra*, at 40. In a healthy housing market, therefore, piggyback second mortgages are a rarity. Second mortgages that are used to purchase a home, furthermore, contribute to an unhealthy housing market.

2. Junior Mortgages Provide A Peripheral Form Of Household Finance

Market data reflect the different roles of first and junior mortgages in a healthy housing market. The market share of first mortgages is substantially greater than that of junior mortgages: homeowners owe $8.7 trillion in outstanding first mortgage debt but less than one-twelfth of that—$680 billion—in outstanding junior mortgage debt. *Financial Accounts of the United States*, *supra*, at 107. Furthermore, 62% of American families have a regular first mortgage, while only 4.4% have a HELOC as a jun-

ior mortgage and 2.0% have a lump-sum junior mortgage. *American Housing Survey*, *supra*, at 75, A-33 (defining regular mortgages as all mortgages other than home equity and reverse mortgages). Overall, first mortgages are nearly ten times as common as junior mortgages, *id.*, and represent almost thirteen times as much debt.

In addition, first and junior mortgages are largely owned by different sectors of the economy and are serviced differently, as well. The vast majority—84.5%—of junior mortgages (including first-lien HELOCs) are held by U.S. banks.[3] *Financial Accounts of the United States*, *supra*, at 107. In our experience, these banks generally service their own junior mortgages. In stark contrast, U.S. banks own only 20.0% of first mortgages (other than first-lien HELOCs). *Id.* Banks often sell these mortgages to GSEs (i.e., Fannie Mae and Freddie Mac) and investors but maintain mortgage servicing rights. *See, e.g.*, *2013 Annual Report*, Bank of Am. Corp. 114, available at http://media.corporate-ir.net/media_files/IROL/71/71595/AR2013.pdf (describing mortgage servicing rights). GSEs own 49.9% of first mortgages, and back an additional 15.9% in mortgage pools.[4] *Financial Accounts of the United States*, *supra*, at 107. These holders of first mortgage debt pay dedicated servicing companies (sometimes divisions of banks) to manage their first mortgages.

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[3] Another 10.8% of junior mortgages are held by credit unions, and 4.6% are held by investors (including finance companies and holders of mortgage-backed securities). *Financial Accounts of the United States*, *supra*, at 107.

[4] Most of the remainder are held in asset-backed securities (7.7%) or by credit unions (3.2%). *Id.*

See, e.g., *2013 Annual Report*, *supra*, at 39 (reporting $550 billion of mortgage loans serviced by Bank of America on behalf of investors).

First mortgages, therefore, have a wide impact across economic sectors, while junior mortgages are largely the domain of banks. Protecting junior mortgages in bankruptcy would likely benefit Bank of America, whose home equity portfolio makes up 18% of its consumer portfolio, *id.* at 79, but Bank of America's incentives are not aligned with those of other players in the market. By contrast, first mortgages serve the core of the housing market; protecting first mortgages in bankruptcy therefore serves Congress's goal of maintaining a healthy housing market.

Because there is no good reason to extend special protections to junior mortgagees, the Bankruptcy Code should afford a debtor a fresh start by applying Section 506(d)'s general command to void unsecured liens. Junior mortgages ordinarily function as a peripheral form of household finance that, like credit cards, facilitates personal spending. When junior mortgages do facilitate home purchase, they contribute to unhealthy housing and lending markets. Thus, junior mortgages, unlike first mortgages, do not promote Congress's policy goal of maintaining a healthy housing market. Extending *Dewsnup v. Timm*, 502 U.S. 410 (1992), to completely unsecured junior mortgages would not serve the purposes of bankruptcy. Nor would it promote a healthy housing market. Instead, it would merely protect an unhealthy form of household finance.

3. *Several Loan Modification Programs Have Found It Prudent To Favor The Implementation Of First Mortgage Modifications, Rather Than Preserve The Rights Of Second Mortgagees*

The favorable treatment afforded first, as compared to second, mortgages under the federal Home Affordable Modification Program ("HAMP") reflects an implicit understanding of the different policy purposes these two types of loans fulfill. HAMP, implemented by the Department of the Treasury in 2009, along with its program designed specifically to deal with second mortgages (2MP), give junior mortgagees less control in the modification process than first mortgagees. *Treasury and HUD Announce Enhancements to Housing Program*, U.S. Dep't Treasury (Dec. 4, 2014), available at http://www.treasury.gov/press-center/press-releases/Pages/jl9714.aspx. Servicers of second mortgages that participate in 2MP are *required* to offer modifications to second mortgagors if they have already modified their first mortgage under HAMP These modifications are automatic, do not involve underwriting, and follow a strict set of guidelines. Also, second mortgage modifications under 2MP do not have to pass the HAMP "net present value test"[5] because it is assumed that any recovery through 2MP would be of greater value than foreclosure for an underwater second mortgage. *Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages*, U.S. Dep't Treasury 158-167 (Aug.

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[5] The net present value test determines whether the proposed modification would produce a greater return than a foreclosure for the loan's investor.

17, 2012), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_44.pdf (hereinafter *MHA Handbook*). 2MP servicers are required to re-subordinate junior liens in order to "facilitate the modification of a first lien under HAMP," notwithstanding the resulting loss of security relative to the property's fair market value. *MHA Handbook*, *supra*, at 170. Under HAMP, the goal of arriving at a modification beneficial to first mortgagees and homeowners is prioritized over the interests of second mortgagees.

The 2012 settlements Petitioner and four other large mortgage servicers reached with the federal government and the Attorneys General of forty-nine states reflect the same understanding: second mortgages do not serve an essential function in healthy housing markets. Servicers receive substantially more credit towards their settlement obligations for modifying and forgiving first mortgage debt than second mortgage debt. For example, the consent judgment for the Petitioner provides "one-to-one" credit for principal reductions on underwater first mortgages, whereas for performing second mortgages, it provides only $0.90 credit for every dollar in write-downs. For principal reductions on seriously delinquent second liens (90 to 179 days delinquent) the judgment provides only $0.50 credit on the dollar. Consent Judgment, *United States v. Bank of Am. Corp., et al.*, No. 12–0361, at D-4, D-5 (D.D.C. Apr. 4, 2012). One reason the judgment provides credit for extinguishing second liens at all is to "support the future ability of the individuals to become homeowners." *Id.* at D-6. By crediting less to second lienholders for modifications, the settlements reaffirm the

fact that government actors value them less than first mortgages.

II. Junior Mortgages Interfere With Efficient Resolutions Of Troubled Mortgages, Harming First Mortgagees And Discouraging Purchase-Money Residential Lending

When a homeowner becomes financially distressed, the distinctions between first and second mortgagees become even more crucial. Without a means of voiding junior liens, entirely underwater second mortgagees can exert their hostage power to prevent economically efficient bargains, harming first mortgagees and the housing market. This undermines federal policy in three ways. First, it frustrates a central purpose of bankruptcy by allowing an out-of-the-money junior mortgagee to hold up a resolution that would maximize recovery for creditors as a whole, instead encouraging value-destroying foreclosures. Second, this destruction of value hurts senior mortgagees and therefore undermines federal policies that aim to provide a healthy and functional housing market. Finally, the ban on voiding underwater second mortgage liens threatens the fresh start that bankruptcy offers to the debtor, and is detrimental to surrounding communities, municipalities, and society at large.

A. Second Mortgagees Create A Hold-Up Problem By Hindering Economically Efficient Short Sales And Deeds-In-Lieu

A central lesson of the recent housing crisis is that voluntary mortgage modifications and short sales are often better ways for a mortgagee to realize value than enforcing its rights to the underlying col-

lateral under state law—particularly when a property is over-leveraged. *See* Cong. Oversight Panel, *Foreclosure Crisis: Working Toward a Solution, March Oversight Report* 6 (2009) ("When compared with the costs of foreclosure, the cost of loan workouts can often provide a more efficient, economically rational outcome for both the borrower and the lender."). Unfortunately, the presence of a fully underwater junior mortgage frequently hinders or prevents such economically efficient resolutions. *See, e.g.*, Christopher Mayer et al., *A New Proposal for Loan Modifications*, 26 Yale J. on Reg. 417, 419 (2009) ("[S]econd liens can be a barrier to successful modifications of first mortgages.").

Underwater junior mortgages not only hinder the loan modification process, as illustrated in Respondents' brief, but also frequently prevent workouts seeking to transfer ownership of the property and avoid the foreclosure process where loan modification and home retention are not possible or desirable. Where, as in the present case, the homeowner has no equity in the property, borrowers and first mortgagees often seek to resolve the defaulted loan and avoid a value-destroying foreclosure through one of two methods. First, they may attempt a short sale, in which the first mortgagee agrees to accept a reduced payoff of the debt (among other financial considerations) in return for the homeowner selling the property through the open market. *See, e.g.*, 24 C.F.R. § 203.370 (providing guidelines for short sales on Federal Housing Administration ("FHA") mortgages). Second, they may negotiate a deed-in-lieu, in which the borrower voluntarily transfers title to the mortgagee in exchange for financial considerations, typically waiver of any defi-

ciency between the value of the property and the total debt owed. *See, e.g.*, 24 C.F.R. § 203.357 (providing for conveyance by deed-in-lieu for FHA mortgages).

First mortgage investors in such situations stand to recover significantly more through these workouts than they would in the event of a foreclosure. A short sale maximizes the proceeds realized by the lender by allowing the house to be sold at or close to fair market value, rather than at the significantly discounted price it would receive in a foreclosure. *See* John Y. Campbell et al., *Forced Sales and House Prices* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), available at http://www.nber.org/papers/w14866.pdf (finding that foreclosures result in an average discount of 28% relative to fair market value). Likewise, a deed-in-lieu allows the mortgagee to acquire the home without incurring the expenses associated with a foreclosure.

Although these options preserve value for the first mortgagees, they can be blocked by a junior mortgagee whose lien must be released in order to effectuate the transfer. Vicki Been et al., *Essay: Sticky Seconds—the Problems Second Liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J. L. & Bus. 71, 84 (2012). This is so even though the fully underwater second mortgagee would recover nothing in the event of a foreclosure of an underwater property, because no excess proceeds would be available to distribute to junior lienholders. Therefore, the costs of a failure to reach a deal are imposed on the first mortgagee in the form of (1) the discounted sales price discussed above and (2) the costs

of the foreclosure. Since a large proportion of both the costs and benefits of negotiating a more efficient alternative to foreclosure accrue to other stakeholders, junior mortgagees are less likely to invest in negotiating alternatives, resulting in inefficient foreclosures. *Id.* at 97.

When junior mortgagees do cooperate with a short sale or deed-in-lieu, they generally condition their cooperation on an extortion-like payoff of thousands of dollars from the parties, a cost typically shouldered by the first mortgagee. *See, e.g.*, Sumit Agarwal et al., *Second Liens and the Holdup Problem in First Mortgage Renegotiation* 5 (Fisher Coll. of Bus., Working Paper No. 2014-02, 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2022501 ("Second lien owners have an incentive to 'hold up' any resolution (modification or liquidation) of the mortgage unless they can recover some price above the true value of their claim."). Our organizations have seen second mortgagees demand and receive payoffs of several thousand dollars to cooperate with a short sale. In fact, such demands are so common that regulators have had to account for them when designing short sale programs. For example, when the Federal Housing Finance Agency ("FHFA") announced a new short sale program for Fannie Mae and Freddie Mac in 2012, it provided for payments of up to $6,000 to second lien holders, explaining that "[p]reviously, second lien holders could slow down the short sale process by negotiating for higher amounts." *FHFA Announces New Standard Short Sale Guidelines for Fannie Mae and Freddie Mac*, Fed. Hous. Fin. Agency (Aug. 21, 2012), available at http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-New-Standard-Short-Sale-Guidelines-

for-Fannie-Mae-and-Freddie-Mac.aspx. Whether by preventing a short sale or demanding a payoff, the junior mortgagee creates an economic loss for the first mortgage investors, despite the latter's senior lien position.

Furthermore, because of the transaction costs involved, underwater seconds are actually much more deeply underwater than may appear using standard valuation methods. Given the standard realtor commission of 6%, typically paid by the homeowner, and the other transaction and moving expenses incurred by such sellers, even a homeowner with "theoretical" equity on paper often will be underwater in fact. *See* Adam J. Levitin & Susan M. Wachter, *Second-Liens and the Leverage Option* 6 (U. of Penn. Inst. for Law & Econ., Research Paper, 2015), available at http://ssrn.com/abstract=2556687. If the transaction costs are, conservatively, 9% of the total price, the sale of a property with a fair market value of $100,000 will net just $91,000. If the homeowner had both a first mortgage for $95,000 and a second for $20,000, the second mortgage that seemed to be just partially underwater is in fact fully underwater once the transaction costs of the sale are accounted for. In a foreclosure, the transaction costs reduce the liquidated value even more significantly, as explained above. Thus existing law under *Dewsnup* already over-protects second mortgage creditors by including in its ambit second mortgages which are partially underwater on paper, but are, in fact, fully underwater. *Dewsnup* should not be extended further to include second mortgages that are wholly underwater.

B. The Bankruptcy Code Is Designed To Solve This Hold-Up Problem For The Benefit Of Creditors And Other Stakeholders

When a second mortgage is fully underwater, the hold-up value will generally be the only value the second mortgage retains. *See id.* at 18. Since bankruptcy is fundamentally designed to eliminate such hold-up problems, this value is not one that the bankruptcy process protects. Rather, bankruptcy is designed to distribute any available assets based on the relative priorities of the creditors as they are frozen at the time of filing. Holdups by effectively unsecured creditors contravene this purpose by allowing a creditor in a junior position to either extract value from a more senior creditor, or force an economically inefficient foreclosure that destroys the value of the underlying asset.

Since this loss is primarily borne by the first mortgagee, it also undermines Congress's policy goal of promoting a healthy housing market. The imposition of these costs makes the purchase-money lender's investment less certain, and therefore less attractive. Since junior mortgages are not essential components of a housing market that enables homeownership, protecting them from lien voiding at the expense of first mortgagees frustrates fundamental policy goals and is likely to lead to lower homeownership rates.

In addition to the negative impact on first mortgage investors, forcing distressed mortgages to be resolved through the foreclosure process rather than through voluntary mechanisms also is detrimental to homeowners, surrounding communities, and society

as a whole. For homeowners, prohibiting lien voiding on fully underwater junior mortgages threatens their opportunity for a fresh start through bankruptcy. In roughly half of the states that utilize judicial foreclosure, the foreclosure process requires the expenditure of public resources to support the increased demands on the court system. *See* The Washington Economics Group, Inc., *The Economic Impacts of Delays in Civil Trials in Florida State Courts Due to Underfunding* (2009) (finding that insufficient funding of the judicial system led to backlog of foreclosure cases at a cost of $9.9 billion to Florida citizens). Foreclosures have been widely documented to have a negative impact on the property values of surrounding properties. *See, e.g.*, Zhenguo Lin et al., *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. Real Estate Fin. & Econ. 387 (2009) (documenting a statistically significant diminution of property value within a 10 block radius and lasting five years from the date of foreclosure). Foreclosures also have significant adverse budgetary impacts on local governments, which suffer a loss of property tax revenue while simultaneously dealing with an increased need for municipal services. *See, e.g.*, G. Thomas Kingsley, Robin Smith & David Price, The Urban Inst., *The Impacts of Foreclosures on Families and Communities* 18 (2009).

C. The Connecticut General Assembly Has Recognized, But Not Fully Solved, This Problem

Recent Connecticut legislation, An Act Concerning an Optional Method of Foreclosure, Public Act 14-84 (the "Act"), acknowledges the problems posed

by junior lienholders and seeks to facilitate economically beneficial outcomes by creating a way to pass over second mortgagees' holdout rights. Conn. Pub. Act No. 14-84 (2014). The Act, which took effect on January 1, 2015 (pursuant to the subsequent Public Act 14-217), provides "foreclosure by market sale" as an alternative method for carrying out foreclosures. Both houses of the Connecticut General Assembly, understanding the threat second mortgages pose to restoring a healthy housing market, passed the bill unanimously. Under the Act, homeowners and first mortgagees can agree to short sell an underwater property without obtaining consent from junior lienholders. *See Testimony of Scott J. Sandler, Esq. Concerning Raised Bill No. 5514* (Mar 11, 2014) (statement of Scott J. Sandler) (noting that the Act "essentially permits a short sale to take place without any input from or approval of junior lien holders").

The Act allows for second mortgagees to maintain their interests in the property, but only upon their own initiative and at the expense of paying the full cost of the property, regardless of how much the borrower already owes the second mortgagee. Thus the short sale process can no longer be brought to a standstill in Connecticut by junior lienholders. Having a buyer in place before foreclosure is complete also allows the property to be sold at a higher price than at foreclosure auctions. *See Testimony Before The Banks Committee of the Connecticut General Assembly* (Mar. 11, 2014) (statement of Martin J. Geitz).[6] The Act effectively prioritizes securing an

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[6] Mr. Geitz testified that the Act "creates a 'pre-foreclosure' sales solution that will provide homeowners with no equity in

economically beneficial outcome for senior mortgagees over the right of an unsecured junior lienholder to slow down or otherwise obstruct the process.

While the Connecticut legislation demonstrates the need for effective mechanisms to address the difficulties posed by underwater second mortgages, it does not solve the problem. First, it cannot address these concerns in the other forty-nine states. Second, it only resolves the second mortgage hold-up problem in the context of short sales, and cannot address the problems second mortgagees pose to homeowners who seek to retain their homes through modifications or refinances. Thus, enforcing the lien voiding required by 506(d) in bankruptcy remains an important tool in renegotiating mortgages throughout the country.

III. A Ruling For Respondent Will Not Open The Floodgates To Lien Voiding

A. Borrowers Will Still Be Reluctant To Utilize Bankruptcy As An Alternative To Foreclosure

While junior lien voiding in bankruptcy would provide borrowers with greater bargaining power, utilizing such an alternative to foreclosure would still be costly and difficult for the borrower. By threatening to turn to bankruptcy to have the junior lien voided, borrowers could more effectively prevent

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their properties the ability to quickly and efficiently sell their properties without the stigma of foreclosure . It also has the potential to produce better sales prices for homeowners using this new approach." *Testimony Before The Banks Committee of the Connecticut General Assembly*, *supra*.

junior lienholders from impeding first mortgage modifications. *See* Part II, *supra*; *see also* Christopher J. Mayer et al., *Mortgage Modification and Strategic Behavior: Evidence from a Legal Settlement with Countrywide* (Nat'l Bureau of Econ. Research, Working Paper No. 17065, 2011), available at http://www.nber.org/papers/w17065 (discussing an example of borrower strategic behavior). Yet the costs of bankruptcy make it difficult for the borrower to use filing as a credible threat to lenders. The longer-term adverse effects of bankruptcy make it a less attractive alternative to foreclosure, and many individuals view bankruptcy as a last resort, rather than a platform for opportunistic behavior.

Despite the benefits of starting afresh, the process of filing for bankruptcy greatly encumbers debtors. Since the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. 109-8, 119 Stat. 23, the requirements for Chapter 7 bankruptcy filings have become more stringent. BAPCPA implemented a means test to keep "can-pay" debtors from abusing the benefits of bankruptcy. *See, e.g.*, Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 Am. Bankr. Inst. L. Rev. 665 (2005). Additionally, the debtor must now produce a wider variety of documents for review. *See, e.g.*, 11 U.S.C. §§ 521(a)(1)(B)(iv), 521(f). Many of the new requirements necessitate legal counsel and the burden falls to the debtor to pay the resulting fees. *See* James J. White, *Abuse Prevention 2005*, 71 Mo. L.

Rev. 863 (2006). The result of BAPCPA has been to keep potential claims out of bankruptcy court.[7]

Not only is filing for bankruptcy a difficult process, bankruptcy has pervasive and lingering negative effects on the filer. A personal bankruptcy flag on a credit report substantially lowers an individual's creditworthiness. David K. Musto, *What Happens When Information Leaves a Market? Evidence from Postbankruptcy Consumers, Journal of Business*, 77 J. Bus. 725 (2004). Given the ubiquitous use of credit scores in today's financial markets (let alone employment, rental and insurance markets), any lowering of an individual's credit score causes significant negative repercussions by reducing the availability of future credit. Satyajit Chatterjee, et al., *A Theory of Credit Scoring and Competitive Pricing of Default Risk* (Apr. 2011) (unpublished paper) (on file with the University of Minnesota). Many homeowners who seek assistance from CFHC are reluctant to pursue bankruptcy even if it is an economically beneficial choice. This has largely to do with the nega-

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[7] See also Robert M. Lawless, et al., *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 Am. Bankr. L.J. 349 (2008). Sen. Elizabeth Warren and Professor Robert Lawless argue that even as financial stresses intensify for consumers, bankruptcy filings have not increased accordingly. They estimate that in the years immediately after the implementation of BAPCPA, 800,000 families were discouraged from filing bankruptcy by its procedural changes. *Id.* at 375. Bankruptcy filings spiked in the immediate aftermath of the 2008 financial crisis, but have since fallen to pre-2008 levels. *Bankruptcy Filings Drop Nearly 13 Percent in Calendar Year 2014*, U.S. Courts (Jan. 28, 2015), http://news.uscourts.gov/bankruptcy-filings-drop-nearly-13-percent-calendar-year-2014.

tive connotations some homeowners have regarding bankruptcy and the variety of negative consequences that flow from filing for bankruptcy, discussed *supra*. Based on our experience, even if the Eleventh Circuit's judgments are affirmed, many individuals with underwater second liens would still refuse to file bankruptcy.

B. Wholly Underwater Second Liens Are Uncommon; Thus, A Ruling In Favor Of Respondent Is Unlikely To Cause A Substantial Surge In Lien Voiding

In the experience of CFHC, few homeowners seeking foreclosure assistance in recent years were burdened by completely underwater second mortgages. Out of a random sample of 177 homeowners for whom CFHC conducted a foreclosure prevention intake in 2013 and 2014, only 21, or less than 12%, reported having second mortgages that were completely underwater. This figure may also be higher than the proportion of underwater second mortgages nationwide because CFHC services four cities in the top one hundred cities with the highest negative equity in the country (including Hartford, Connecticut, the most underwater city in the nation, with a negative equity rate of 56%). Haas Inst., *Underwater America*, U.C. Berkeley (2014). Even while working in a region with high negative equity, CFHC has not observed a large percentage of wholly underwater second liens. Because financially distressed homeowners only occasionally have wholly underwater second liens, any effect from the Court's affirmance of the Eleventh Circuit's decision is likely to be minimal.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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Respondent.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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Min Qi & Xiaolong Yang, *Loss Given Default of High Loan-to-Value Residential Mortgages* (Office of the Comptroller of the Currency, OCC Economics Working Paper 2007-4, 2007) 7

Restatement (Third) of Property: Mortgages § 7.1 (1997) 11, 12

Restatement (Third) of Property: Mortgages § 7.4 (1997) 12

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Vicki Been et al., *Sticky Seconds: The Problems Second-liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J. L. & Bus. 71, 81 (2012) 7, 19, 20, 21, 40

Wenli Li et al., *Using Bankruptcy to Reduce Foreclosures: Does Strip-Down of Mortgages Affect the Supply of Mortgage Credit?* (Fed. Res. Bank of Phila. Working Paper No. 14-35, 2014)..... 27, 28

INTEREST OF AMICUS[1]

Adam J. Levitin is Professor of Law at Georgetown University Law Center, where he teaches courses on bankruptcy, commercial law, and consumer finance, including mortgage lending. Professor Levitin has previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel for Mortgage Affairs to the Congressional Oversight Panel for the Troubled Asset Relief Program. In 2013, Professor Levitin was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin's interest in this case is both as a scholar of bankruptcy law and mortgage finance and because he has authored or co-authored two studies that examine the effect of permitting mortgage lien-stripping on the cost and availability of credit. *See* Joshua Goodman & Adam J. Levitin, *Bankruptcy Law & the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates*, 57 J. L. & Econ. 139 (2014); Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 Wisc. L. Rev. 565.

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[1] Pursuant to Rule 37.6, Amicus affirms that no counsel for a party authored this brief in whole or in part, and that no person other than Amicus and his counsel made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

In *Dewsnup v. Timm*, 502 U.S. 410, 416-17 (1992), the Court recognized the difficulties in a hypothetical application of section 506(d) of the Bankruptcy Code, 11 U.S.C. § 506, "to all possible fact situations" and expressly limited its holding to the facts of that case. The instant cases address a factual situation distinct from *Dewsnup*. Professor Levitin's explanation of the particular legal and economic features of second-lien lending, the structure of the second-lien lending industry, and the empirical scholarship on the impact of bankruptcy law on mortgage lending, will aid the Court's decisional process in applying section 506(d) to the facts of these cases.

SUMMARY OF THE ARGUMENT

Petitioner and its amici present these cases as generally being about secured creditors' rights in bankruptcy; further, they assert that second liens are no different from first liens other than in terms of priority. Accordingly, Petitioner and its amici argue that the Court's analysis in *Dewsnup* should apply with equal force to the cases before the Court and that failing to extend *Dewsnup* to the second-lien mortgage market will upset the market's settled expectations.

Dewsnup, however, was expressly limited to its facts, which involved a partially underwater first-lien mortgage, meaning that the mortgage had a loan-to-value ratio (LTV) of over 100%. Fundamental legal and economic differences between first-lien and second-lien mortgage lending

distinguish the instant cases from *Dewsnup* and suggest that *Dewsnup* should not be extended. Applying *Dewsnup* to cases involving wholly underwater second-lien mortgages would have the perverse effect of enabling Petitioner to do *better* in bankruptcy than it would at state law. Such an outcome would be inconsistent with *Dewsnup*, which was premised on giving the parties only "what was bargained for by the mortgagor and the mortgagee." 502 U.S. at 417. (Parties, of course, always contract against the backdrop of bankruptcy law and the risks it creates.)

Petitioner's arguments about the impact of affirming the decisions below run contrary to all empirical evidence about the effect of lien-stripping in bankruptcy on interest rates. The empirical evidence shows that mortgage lien-stripping in bankruptcy has little or no effect on either interest rates or the availability of mortgage loans. Indeed, the empirical findings make sense because a lender's losses from lien-stripping in bankruptcy are often smaller than a lender's losses in a state law foreclosure. The issue is not zero losses versus losses from lien-stripping, but losses from lien-stripping versus the losses that would obtain in a foreclosure outside of bankruptcy. Moreover, changes in the industrial organization of the mortgage market mean that lien-stripping may often be preferable to mortgage investors, even if not to the banks that service the mortgage loans.

Irrespective of the magnitude of the effect of permitting lien-stripping on interest rates, reversing *Dewsnup* or simply declining to extend it to wholly underwater second-lien mortgage loans is unlikely to affect mortgage markets for a simple reason: the market for high cumulative loan-to-value ratio (CLTV) second-lien mortgages is virtually dead.[2] There is a legacy pool of existing underwater second-lien mortgages, but there is no significant ongoing market that would be affected by permitting lien-stripping on these loans. Given the abuses that occurred in the second-lien mortgage market, this Court should not resuscitate it.

ARGUMENT

I. Legal and Economic Differences Between First-Lien and Second-Lien Mortgages Distinguish This Case from *Dewsnup*.

A. The Particular Type of Second-Lien Mortgages at Issue in This Case Are Almost Entirely Creatures of the Housing Bubble.

The distinguishing feature of a second-lien mortgage loan is that it is secured by a lien that is of second priority. Beyond this basic feature, however, there is significant variation within the

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[2] The CLTV ratio is the sum of the LTV ratios of all mortgages on a property.

second-lien mortgage market. Some second-lien mortgages secure close-end installment loans, while others secure open-end revolving lines of credit known as home equity lines of credit. Some second-lien mortgages are made to borrowers with very good credit, while others are made to "aspirational" or "subprime" borrowers.

The issue in this case concerns primarily close-end (non-revolving) term loans made to subprime borrowers. In contrast, second-lien mortgages made to prime borrowers are often open-end (revolving) home equity lines of credit. Donghoon Lee et al., *A New Look at Second-liens*, 569 Fed. Reserve Bank of N.Y. Staff Rep. 7 at 3 (2012). Prime home equity lines of credit are typically made well after the first-lien loan has been originated, and thus partially paid down. *Id.* at 6. Accordingly, the CLTVs on properties when these home equity lines of credit are fully drawn is typically nowhere close to 100%. Assume, for example, that a borrower with a first mortgage currently at 60% LTV wishes to redo her kitchen, and that interest rates have gone up since the borrower took out the first mortgage. Instead of refinancing at a higher rate, the borrower will simply get an additional mortgage loan, perhaps for another 10% LTV, to cover the costs of the kitchen renovation, resulting in a 70% CLTV. This sort of prime second mortgage is a long-standing product and is unlikely to ever be wholly underwater like the loans in these cases.

During the housing bubble years, a different type of second-lien mortgage arose, the so-called "piggyback." The piggyback second was a loan designed to evade the statutory leverage restrictions on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Company (Freddie Mac). Fannie Mae and Freddie Mac are prohibited, by statute, from purchasing mortgage loans with a LTV over 80%, unless there is first-loss private mortgage insurance covering the loan. 12 U.S.C. § 1717(b)(2); 12 U.S.C. § 1454(a)(2). Private mortgage insurance premiums add to the cost of borrowing. Therefore, to expand market share, some lenders sought to evade the Fannie/Freddie restriction by making two loans to the borrower: one a first-lien loan for 80% LTV, which could be sold to Fannie Mae or Freddie Mac, and then a second-lien loan for as much as 20% LTV These piggyback mortgages substituted for the borrower's down payment, and resulted in a CLTV of 100% on the property, meaning that the borrower would have no equity in the property.

Piggyback second-lien mortgages could not be sold to Fannie Mae or Freddie Mac, 12 U.S.C. § 1717(b)(5)(C); 12 U.S.C. § 1454(a)(4)(C), but they could be securitized in the private-label securitization market[3] or, as was often the case,

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[3] "Private-label" securitization is the issuance of mortgage-backed securities that are not guaranteed by

they remained on the balance sheet of the lender. In either case, the lender might still bear the credit risk on the mortgages, either because the lender owns the loans or because the lender made representations and warranties about the loan's quality and underwriting in the securitization process. Piggyback seconds are associated with higher CLTVs and thus lower down payments. *See* Vicki Been et al., *Sticky Seconds: The Problems Second-liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J. L. & Bus. 71, 81 (2012); Lee et al., 569 Fed. Reserve Bank of N.Y. Staff Rep. at 6-7, 13-14. Higher CLTVs correlate with an increased probability of default. *See, e.g.*, Eduardo S. Schwartz & Walter N. Torous, *Mortgage Prepayment and Default Decisions: A Poisson Regression Approach*, 21 R. E. Econ. 431, 445-46 (2003); Christopher Mayer et al., *The Rise in Mortgage Defaults*, 23 J. Econ. Perspectives 27, 40-43 (2009). Higher CLTVs also correlate with greater loss severities upon default. *See, e.g.*, Min Qi & Xiaolong Yang, *Loss Given Default of High Loan-to-Value Residential Mortgages* (Office of the Comptroller of the Currency, OCC Economics Working Paper 2007-4, 2007).

Respondent Caulkett's second-lien mortgage was a piggyback mortgage. It was made for 20% of the property's value and was made by the same

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Fannie Mae, Freddie Mac, or the Government National Mortgage Association (Ginnie Mae).

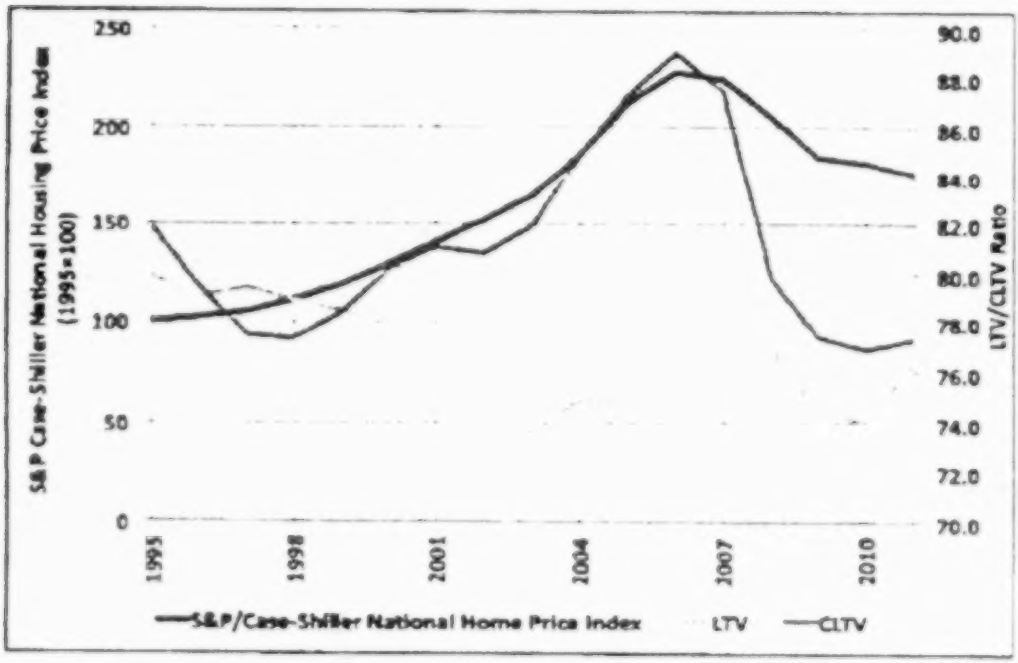
lender (Countrywide Financial) on the same date as the first-lien mortgage made for 80% of the property's value. Together these mortgages *at the time they were made* had a 100% CLTV. Caulkett Opp. Br. at 5-6. At the time Caulkett filed for bankruptcy, the LTV on his first mortgage was 187.5% and the CLTV of the first and second mortgages was 235.8%. *Id.*

Respondent Toledo-Cardona's second-lien mortgage was not a piggyback loan made simultaneously with the first-lien mortgage, but was made subsequent to the first-lien mortgage. Toledo-Cardona's second-lien mortgage was made when Toledo-Cardona already had a first-lien loan for more than 100% of the property's value. Toledo-Cardona Opp. Br. at 5-6. At the time Toledo-Cardona filed for bankruptcy, the LTV on his first mortgage was 174.7%, and the CLTV of the first and second mortgages was 215.9%. *Id.* Toledo-Cardona's second-lien mortgage was apparently an interest-only loan, *id.*, meaning that the principal balance of the second-lien mortgage—and hence the CLTV on the property—was not decreasing with periodic payments.

Second-lien mortgages, such as piggybacks, contributed mightily to the increase in mortgage leverage during the housing bubble. Figure 1 shows that during the housing bubble years of 2003-2007 there was a slight increase in LTVs on first-lien purchase money mortgages, but that the real increase in homeowner leverage was in CLTVs.

An increase in CLTVs, but not first-lien LTVs, indicates that homeowners have increased their mortgage leverage via second mortgages. Figure 1 also shows that the increase in CLTVs (but not in first-lien LTVs) closely tracked the increase in home prices, as increased loan amounts enabled housing prices to be bid up. Not surprisingly, then, homes with junior liens account for over half of the negative equity in the United States. Michael LaCour-Little et al., *The Role of Home Equity Lending in the Recent Mortgage Crisis*, 42 R.E. Econ. 153, 155 (2014).

Figure 1. First-Lien Purchase Money LTV and CLTV Ratios over Time[4]



Formally, the Bankruptcy Code does not distinguish among types of second-lien mortgages, but functionally, the treatment of wholly underwater second-lien mortgages is almost entirely a piggyback mortgage problem associated with the collapse of the housing bubble.

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[4] Adam J. Levitin & Susan M. Wachter, *Second-Liens and the Leverage Option* 13 (Jan. 28, 2015) (unpublished article) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2556687.

B. Second Liens Routinely Become Worthless Under Both State and Federal Law, Unlike First Liens.

1. Foreclosure of a Senior Lien Discharges All Junior Liens, But Foreclosure of a Junior Lien Does Not Affect Senior Liens.

A lien may be released from collateral property in one of three ways: redemption, forgiveness, and foreclosure. Relevant to the instant cases is the release of a lien through foreclosure.

A foreclosure sale discharges the lien of the creditor that commences the sale *and any junior liens* that have been properly notified or joined under applicable law. Restatement (Third) of Property: Mortgages § 7.1 (1997). Therefore, if a first mortgagee brings a foreclosure sale, the sale discharges the liens of the second mortgagee, third mortgagee, etc., *irrespective of whether these junior lienholders have been paid anything from the sale proceeds.*

The junior lienholders are paid only to the extent that the sale proceeds exceed the costs of the sale and the first-lien. Restatement (Third) of Property: Mortgages § 7.4 (1997). The former junior lienholder may still bring an action on the debt, but many states have limitations on the ability to do so, either because the loan was non-recourse or because of restrictions on foreclosure deficiency judgments.

In contrast, a foreclosure sale by a junior lienholder does not affect the liens of any senior lienholders. Restatement (Third) of Property: Mortgages § 7.1 (1997). Those *liens* remain attached to the property in the hands of the foreclosure sale purchaser, even though the *debt* is still owed by the original borrower. Thus, if the debt is not paid by the original borrower, the senior lienholder(s) can foreclose and take the property away from the purchaser at the junior lienholder's foreclosure sale.

Consider, for example, a home worth $150,000 and secured by a first mortgage for $100,000 and a second mortgage for $20,000. If the second mortgagee forecloses, the buyer will receive a home worth $130,000, but subject to a $100,000 first mortgagee's lien. The debt, however, is still owed by the original borrower. Therefore, unless the *buyer* pays off the $100,000 first mortgage owed by the original borrower, the first mortgagee will foreclose on its mortgage and deprive the *buyer* of the property._Therefore, the buyer will rationally

discount its maximum bid by $100,000, the amount of the first mortgage loan. Thus, the maximum bid at the second mortgagee's foreclosure sale would be $50,000.

This means that the legal rights of a second mortgagee are fundamentally different from those of a first mortgagee. The first mortgagee's lien can be discharged only if the debt owed to the first mortgagee is repaid or if the first mortgagee brings a foreclosure sale itself, which it will only do if it believes that the sale proceeds will exceed the costs of the sale. The first mortgagee cannot be deprived of its lien under non-bankruptcy law absent its consent.

In contrast, a second mortgagee's lien can be discharged as the result of a foreclosure by the first mortgagee, without the second mortgagee receiving any of the foreclosure sale proceeds. The second mortgagee's lien is thus at the mercy of the first mortgagee. If the second mortgagee's lien is wholly underwater and the first mortgagee forecloses, the second mortgagee will get nothing.

Furthermore, because a foreclosure by a junior mortgagee does not discharge senior liens, junior mortgagees rarely bring foreclosure actions. This is particularly true for underwater properties. Consider, for example, a home worth $150,000 and secured by a first-lien mortgage for $160,000 and a second-lien mortgage for $40,000. The winning bid at the second-lien foreclosure sale would receive a $150,000 home subject to a $160,000 first-lien

mortgage. No rational bidder would bid for such a property. Accordingly, the second-lienholder would never bring a foreclosure and incur the sale expenses for a sale at which it knows no one will bid.

Indeed, at least one state actually forbids junior mortgagees from bringing foreclosure sales if the sale price would be insufficient to satisfy all obligations secured by senior liens. *See* La. Code Civ. Proc. Ann. art. 2335, 2337. Other states require bidding at a foreclosure sale to start at two-thirds of the newly appraised value of the property. *See, e.g.*, Ark. Code Ann. § 18-50-107(b)(3); Ky. Rev. Stat. Ann. § 426.530 (one-year post-sale right to redeem at sale price, if sale price less than two-thirds of appraised value); La. Code Civ. Proc. Ann. art. 2336 (on first offering property may not be sold for less than two-thirds of appraised value); N.M. Stat. Ann. § 39-5-5 (no property to be sold in foreclosure for less than two-thirds of appraised value); Ohio Rev. Code Ann. § 2329.20 (no property to be sold in foreclosure for less than two-thirds of appraised value); Okla. Stat. tit. 12, § 762 (no property to be sold in foreclosure for less than two-thirds of appraised value). In such cases, no bidder will bid on a sale brought by a junior mortgagee if the first-lien is for more than two-thirds of the property's value.

2. A Wholly Underwater Second Lienholder Receives No Distribution from a "Free and Clear" Sale in Bankruptcy.

Irrespective of section 506(d), a completely underwater second lien can be functionally (if not formally) wiped out in bankruptcy by a "free and clear" sale under section 363(f) of the Bankruptcy Code. Section 363(f) permits the bankruptcy estate to sell assets "free and clear" of creditor's interests in the assets, such as liens under certain conditions. The purchaser in a 363(f) sale takes the assets free of the creditors' liens; the liens instead attach to the proceeds of the 363(f) sale. *See* 11 U.S.C. §§ 363(e), 361, 1129(b)(2)(A)(ii), 1206. The liens thus continue to exist, but the lienholders' recovery will be limited by the extent of the sale proceeds. If a lien is wholly underwater, the proceeds from the sale of the collateral will be insufficient to satisfy a lien, and the lienholder will get no recovery from the sale, just as would occur in a foreclosure sale outside of bankruptcy. Such a wholly underwater lienholder could still recover from the bankruptcy estate's unencumbered assets as a general unsecured creditor.

Two conditions for a "free and clear" sale are applicable to the instant cases. First, under section 363(f)(3), an asset can be sold free and clear of liens if the sale price "is greater than the aggregate value of all liens on such property" 11 U.S.C. § 363(f)(3). Lower courts are split on the

interpretation of this provision, but the view that has "prevailed in practice" is that section 363(f)(3) requires only that the sale price be greater than the fair market value of the liens, rather than greater than the amount of the debt secured by the liens. *See, e.g., In re Boston Generating, LLC*, 440 B.R. 302, 333 (Bankr. S.D.N.Y. 2010); Collier on Bankruptcy ¶ 363.06. Under this reading, a bankruptcy court could order the sale of a property encumbered by both a first mortgage and a wholly underwater second mortgage without the second mortgagee receiving *any* distribution on account of the sale. (The second mortgagee would have a general unsecured claim in the bankruptcy that might receive a distribution from the estate's other assets.)

Second, under section 363(f)(5), an asset can be sold free and clear of liens if the lienholder "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." 11 U.S.C. § 363(f)(5). A junior lienholder could be compelled to accept monetary satisfaction of its interest in a foreclosure by a senior lienholder, *see, e.g., In re Jolan, Inc.*, 403 B.R. 866, 869 (Bankr. W.D. Wash. 2009), and presumably also in an eminent domain action. Again, a wholly underwater second mortgagee would lose its lien without receiving any distribution on account of the lien.

Thus, a completely underwater second-lienholder would get nothing if the bankruptcy

estate sold the home in a 363(f) sale under either section 363(f)(3) or 363(f)(5). Section 363(f), then, enables the bankruptcy estate to force through a "short sale" for less than the amount of the debt secured by the property. As such, "the pre-Code rule that liens pass through bankruptcy unaffected," *Dewsnup*, 502 U.S. at 417, has not survived intact, as least as applied to junior liens. Under the 1978 Bankruptcy Code, the claim that liens necessarily pass through bankruptcy unaffected is at best an overstatement and at worst demonstrably false. To that extent, then, the Court is indeed "writing on a clean slate." *Id.*

3. Unlike Second-Lien Mortgages, First-Lien Mortgages Cannot Be Wholly Underwater.

First-lien mortgages also cannot end up entirely underwater absent the most unusual circumstances. For a first-lien mortgage to end up *entirely* underwater, not only would any structure on the property have to be destroyed, but the land itself would have to have no value. First-lien lenders virtually always require property insurance and have the contractual right to force-place insurance if the borrower lets the insurance lapse. *See, e.g.*, Fannie Mae & Freddie Mac, Form 3044, Uniform Security Instrument § 5 (2015).

Thus, typically only in the most unusual circumstances relating to severe environmental contamination or complete and permanent flooding

would a first-lien lender find itself *wholly* unsecured.

In contrast, a second-lien mortgage could easily find itself wholly underwater, if property values shift. A second-lien lender cannot rely on its loan being partially, much less fully, secured.

In the instant cases, Petitioner's predecessors in interest made loans that were at least partially underwater the minute they were made. The loan made to Respondent Caulkett was a piggyback loan for 100% CLTV Caulkett Opp. Br. at 5-6. Given sale and moving costs, the second mortgage on Caulkett's property was underwater from the beginning. Similarly, the second mortgage on Respondent Toledo-Cardona's property was voluntarily re-subordinated to a refinanced first mortgage that may itself at the time have been for more than the property's value. Toledo-Cardona Opp. Br. at 5-6. In neither case were Petitioner's predecessors in interest relying on property value for recovery of their loans. Instead, they were relying on "hostage" or "hold out" value to compel repayment.

C. Underwater Second-lien Lenders Seek to Recover from Hostage Value Rather Than from Property Value.

A second-lien mortgage lender cannot rely on being even partially secured, cannot rely on the ability to foreclose as a means of repayment, and cannot even count on having a lien because the lien

can be discharged if the first-lien lender forecloses. This means that second-lien lenders have to operate on a different economic model than first-lien lenders. Second-lien lenders aim to be repaid voluntarily by the borrower, but if the borrower does not repay, the second-lien lenders seek to be repaid by being squeaky wheels. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 82.

Thus, if the borrower wanted to refinance the first-lien mortgage, the second-lien lender could block the refinancing by refusing to re-subordinate its lien to the new lien securing the refinanced loan. Since 2009, the Federal government's Home Affordable Refinance Program (HARP) has subsidized refinancings of underwater mortgages owned or guaranteed by Fannie Mae or Freddie Mac. HARP, however, requires a second-lien lender to agree to be re-subordinated before the borrower can receive the government-subsidized refinancing of the partially underwater first-lien mortgage. Fannie Mae, Home Affordable Refinance (DU Refi Plus and Refi Plus) FAQs 3 (2013), *available at* https://www.fanniemae.com/content/faq/harp-du-refi-plus-faqs.pdf; Fannie Mae, 2015 Selling Guide, § B5-5.2-01 (2015); Freddie Mac, Single-Family Seller/Servicer Guide § A24.3 (2014). Second mortgage lenders often demand payments for re-subordination. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 99; Christopher Mayer et al., *A New Proposal for Loan Modifications*, 26 Yale J. on Reg. 417, 419 (2009).

Similarly, second-lien lenders can block "short sales," in which a borrower sells the house for less than the full amount of the first-lien mortgage loan, with the deficiency being forgiven. The second-lien lender can insist on exercising its "due on sale" clause in such a situation, thereby torpedoing the "short sale" unless it is paid off. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 84.

Likewise, second-lien lenders can block a foreclosure alternative known as a "deed in lieu of foreclosure," in which the homeowner simply surrenders the deed to the house to the first-lien lender in exchange for forgiveness of the first-lien debt. If there is a second-lien mortgage on the house, however, the first-lien lender will not want to do a deed in lieu because under the doctrine of merger, the first-lien lender's estates (as owner in fee simple and as first-lien holder) merge into the greater estate of fee simple. *See* Ann M. Burkhart, *Freeing Mortgages of Merger*, 40 Vand. L. Rev. 283, 334-35 (1987). Thus, the first-lien lender would own the property, but subject to the second lien.

Accordingly, without either paying off the second-lien lender or going through the costs of a foreclosure, the first-lien lender will not accept a deed in lieu. Thus, the only potential value in a wholly underwater second-lien mortgage is hostage value.

Indeed, because of the problems underwater second-lien mortgages create for loan restructuring due to their only value being hostage value, the

federal government pays special bounties to second-lienholders as part of the Home Affordable Modification Program (HAMP) for permitting loan modifications or for extinguishing underwater second liens. *See* Been et al., 9 N.Y.U. J. L. & Bus. at 107-09. HAMP addresses the second lien holdout problem using a carrot of government payments.

In contrast, the landmark $25 billion National Mortgage Settlement among 49 states' attorneys general, the federal government, Petitioner, and four other large mortgage servicers, addresses the second lien holdout problem using a stick. The National Mortgage Settlement requires Petitioner and the other large mortgage servicers to reduce the principal balance on second liens whenever there is a principal reduction on a first mortgage. *See* Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361 (D.D.C. Apr. 4, 2012), at D1-1-D1-3; *see also* Been et al., 9 N.Y.U. J. L. & Bus. at 109. The consent judgment also requires that in the case of a short sale or deed in lieu of foreclosure the Petitioner must extinguish any junior lien it holds and forgive the balance secured by that junior lien. *See* Consent Judgment, *United States v. Bank of Am. Corp.*, No. 12-cv-00361 (D.D.C. Apr. 4, 2012), at D7; *see also* Been et al., 9 N.Y.U. J. L. & Bus. at 109.

Whether addressed by carrot or stick, the federal government's actions relating to second mortgages illustrate how the holdout problem can

easily frustrate the attempts of courts and legislators to stabilize the housing market.

D. Bankruptcy Law Disfavors Hostage Value.

Bankruptcy law disfavors hostage value; the fundamental structure of bankruptcy law is designed to reduce holdout value of all sorts. Outside of bankruptcy, a creditor generally cannot be forced to compromise its right to payment. This obviously presents particular difficulties for trying to address the problem of insolvent debtors, who, by definition, cannot repay all of their creditors.

While creditors may refuse concessions outside of bankruptcy, bankruptcy law enables concessions to be forced upon unwilling creditors. Most fundamentally, individual creditors can be bound to a bankruptcy plan irrespective of the creditor's consent. Chapter 7 liquidations and Chapter 12 and Chapter 13 plans do not require any creditor consent whatsoever, while a Chapter 11 plan can be confirmed through majority voting procedures without the consent of all creditors.

Similarly, section 363(f) of the Bankruptcy Code—applicable to all types of bankruptcy—permits assets to be sold "free and clear" of creditors' interests in the assets, including liens. This enables assets to be sold for their market value and not for their value discounted by the amount of the lien(s).

E. Forbidding Lien-Stripping of Wholly Underwater Second Liens Creates a Bankruptcy "Windfall" for Second Mortgagees.

For the reasons Respondents articulate, the Bankruptcy Code's statutory language is properly read not to apply *Dewsnup* to wholly underwater second-lien mortgages. Rather than repeating those (lucid) textual arguments, Amicus seeks to underscore that the legal and economic differences between first-lien and second-lien mortgages differentiate the situation in the instant cases from this Court's decision in *Dewsnup*.

Dewsnup dealt with a partially underwater first-lien mortgage. The instant cases deal with wholly underwater second-lien mortgages, which have substantively different rights under both applicable non-bankruptcy law and under other provisions of bankruptcy law. *Dewsnup* was concerned with upholding "what was bargained for by the mortgagor and the mortgagee." 502 U.S. at 417. Extending that principle to the facts of the instant cases requires affirming the decisions below.

In the instant cases, the Petitioner is requesting that this Court mandate *better* treatment for its wholly underwater second-lien mortgages in bankruptcy than it would receive at state law. Such superior treatment is inconsistent with the principle enunciated in *Butner v. United States* that bankruptcy law primarily creates procedural rights. 440 U.S. 48, 54 (1979). A

bankruptcy should not produce a windfall for an underwater second mortgagee above what the mortgagee would receive in a foreclosure. Given *Dewsnup*'s explicitly narrow holding, Petitioner did not bargain with a reasonable expectation that its liens could not be stripped if they were entirely underwater. *A fortiori*, Petitioner did not bargain for a bankruptcy "windfall" and should not receive one.

II. Empirical Evidence Demonstrates That Affirming the Decisions Below Will Not Disrupt The Settled Expectations of the Mortgage Market.

A. Chapter 13 Lien-Stripping Had a Minimal Effect on Mortgage Credit Costs.

In an empirical study published in a leading peer-reviewed economics journal, Professor Levitin, together with Professor Joshua Goodman of the Harvard Kennedy School of Government, determined that permitting lien-stripping in Chapter 13 bankruptcies resulted in almost no impact on mortgage credit costs. Joshua Goodman & Adam J. Levitin, *Bankruptcy Law & the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates*, 57 J. L. & Econ. 139 (2014). This study suggests that, contrary to the claims of Petitioner and its amici, a decision for Respondents in this case will not disrupt settled expectations.

Between 1978 and the Court's 1993 decision in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), there was a split of authority in the lower courts regarding whether lien-stripping was permitted in Chapter 13 for first-lien mortgages solely on real property that was the debtor's principal residence. (This is sometimes referred to as Chapter 13 "cramdown," not to be confused with the conceptually distinct Chapter 11 "cramdown," which refers to the confirmation of a Chapter 11 plan without the consent of all impaired classes of claims and interests). In *Nobelman*, this Court held unanimously that 11 U.S.C. § 1322(b) prohibited lien-stripping in Chapter 13 on partially underwater first-lien mortgages solely on real property that is the debtor's principal residence. 508 U.S. at 329.

Professors Levitin and Goodman used both the prior split of authority in the lower courts and the subsequent unanimity of authority following *Nobelman* to test the impact of permitting or disallowing lien-stripping on home mortgage interest rates and lending volumes. The timing of the splits in lower court authority allowed Professors Levitin and Goodman to statistically test how a legal rule on lien-stripping affected interest rates. They did this through two "difference-in-differences" analyses, which compare the change in both a test group and a control group following an exogenous event.

The first analysis compared interest rates and lending volumes in judicial districts permitting lien-stripping with districts that did not during the 1978-1993 period. The second analysis looked at the differential effect of the *Nobelman* decision on interest rates and lending volumes in judicial districts that had permitted lien-stripping prior to *Nobelman* compared with districts that had not. In both analyses, Professors Levitin and Goodman statistically controlled for any variation that might occur because of geographic locale or time.

Professors Levitin and Goodman found only very small differences in interest rates and lending volumes based on whether Chapter 13 lien-stripping was permitted. To ensure the results were not dependent on any one statistical analysis, Professors Levitin and Goodman tested their results across several regression models. Depending on model specifications, Professors Levitin and Goodman found an average increase in the cost of credit of only 0.12%-0.16% (12 to 16 basis points). *See* Goodman & Levitin, 57 J. L. & Econ. at 156. This was at a time when average mortgage interest rates were at 8.2%, so an additional 12-16 basis points would translate into around a 1% increase in monthly payments. *Id.* Professors Levitin and Goodman observed larger impacts on borrowers with higher interest rate loans—presumably riskier borrowers—but the magnitude of the impact was still small, namely 0.21% - 0.35% (21-35 basis points). *Id.* at 154.

Professors Levitin and Goodman attribute this small magnitude to several factors, including the rarity of Chapter 13 filings by underwater homeowners relative to the mortgagor population in general, the high percentage of Chapter 13 cases that do not result in completion of a plan and a discharge, and most importantly, the fact that losses from cramdown do not necessarily exceed those in a state law foreclosure. *Id.* at 156.

A subsequent study by researchers affiliated with the Federal Reserve Bank of Philadelphia reached the same conclusions as Levitin and Goodman. *See* Wenli Li et al., *Using Bankruptcy to Reduce Foreclosures: Does Strip-Down of Mortgages Affect the Supply of Mortgage Credit?* (Fed. Res. Bank of Phila. Working Paper No. 14-35, 2014). The Philadelphia Fed study used the same interest rate data used by Goodman and Levitin and employed virtually the same methodology as Goodman and Levitin, but also looked at mortgage application approval data collected under the Home Mortgage Disclosure Act. The Philadelphia Fed study also examined the impact of Chapter 7 lien-stripping decisions and *Dewsnup* as well as Chapter 13 lien-stripping decisions and *Nobelman*.

The Philadelphia Fed study found that permitting Chapter 7 lien-stripping resulted in a 1.8% reduction in mortgage approval, but not to any statistically significant change in interest rates. *Id.* at 14, 20, 29. The Philadelphia Fed likewise found that permitting Chapter 13 lien-

stripping led to a 0.23% (23 basis point) reduction in mortgage interest rates and a 1.1% increase in mortgage approval rates. *Id.* at 15, 20, 30. The Philadelphia Fed study concludes that its results "suggest that introducing mortgage strip-down under either bankruptcy chapter would not have a strong adverse impact on the terms of mortgage loans and could be a useful new policy tool to reduce foreclosures." *Id.* at 20.

Two rigorous empirical studies have found that, historically, permitting lien-stripping has little discernible impact on mortgage credit costs or availability. Neither Petitioner nor its amici are able to cite to *any* research indicating that permitting lien-stripping of wholly underwater second mortgages will have any impact on mortgage lending or the economy more broadly.

B. There Is No Evidence that Lenders Currently Charge Higher Interest Rates to Account for Lien-Stripping Risk.

The Levitin-Goodman study and the Philadelphia Fed study both examined the 1978-1993 mortgage market, not the 2015 mortgage market. Yet, there is reason to believe that these findings would carry over to the current market.

Other current market indicators show that the market does not generally price for lien-stripping risk on properties that can still be lien stripped in Chapter 13. Three circuit courts of

appeals permit lien-stripping in Chapter 13 of wholly-or-partially underwater first mortgages that are not secured *solely* by the borrower's principal residence, but also include other collateral, such as an attached basement apartment or fixtures. *See In re Scarborough*, 461 F.3d 406 (3d Cir. 2006); *In re Thompson*, 77 Fed. Appx. 57 (2d Cir. 2003); *Lomas Mortg., Inc. v. Louis*, 82 F.3d 1 (1st Cir. 1996); *In re Hammond*, 27 F.3d 52 (3d Cir. 1994). And all eight circuit courts of appeals to address the issue have permitted lien-stripping in Chapter 13 of wholly underwater second mortgages. *In re Pond*, 252 F.3d 122, 126 (2d Cir. 2001); *In re McDonald*, 205 F.3d 606, 611 (3d Cir. 2000); *In re Davis*, 716 F.3d 331, 336 (4th Cir. 2013); *In re Bartee*, 212 F.3d 277, 288 (5th Cir. 2000); *In re Lane*, 280 F.3d 663, 667–69 (6th Cir. 2002); *In re Schmidt*, 765 F.3d 877, 881–82 (8th Cir. 2014); *In re Zimmer*, 313 F.3d 1220, 1226 (9th Cir. 2002); *In re Tanner*, 217 F.3d 1357, 1359–60 (11th Cir. 2000). *But cf. In re Woolsey*, 696 F.3d 1266, 1272 (10th Cir. 2012) (reserving interpretation of § 1322(b)(2) "and its meaning for another day" because petitioner refused to argue it).

Despite this difference in lien-stripping risk, there is no observable difference in pricing of private mortgage insurance based on whether properties are potentially subject to lien-stripping. *See* Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 Wisc. L. Rev. at 593-596. Similarly, no pricing difference can be observed based on

property type (and hence Chapter 13 lien-stripping risk) in either the primary mortgage market, *id.* at 586-93, or the guarantee fees charged by Fannie Mae and Freddie Mac in the secondary market. *Id.* at 597-98.

C. Lenders Are Unlikely to Charge Higher Interest Rates to Account for Lien-Stripping Risk if Bankruptcy Judges' Valuations Are Correct.

1. There Is No Reason to Believe Judicial Valuations Are Lower than Foreclosure Sale Prices.

There was no evidence of adverse pricing based on lien-stripping risk in the 2009 mortgage market for a simple reason: the alternative to lien-stripping is not payment in full, but the recovery the lender could get in a state law foreclosure proceeding or out-of-court loan restructuring.

Unless bankruptcy courts systematically undervalue properties, there is no reason to think that lenders would have larger recoveries in state law foreclosure proceedings. Wholly underwater mortgages simply get wiped out in state law foreclosure sales with zero recovery, so lien-stripping in bankruptcy is no worse of an outcome.

2. Judicial Valuation Is Essential to the Functioning of the Bankruptcy System.

There is no reason to believe that bankruptcy courts do a poor job at valuations,

particularly for relatively simple assets such as single-family residences. Similarly, there is no reason to think that bankruptcy judges are biased in one direction or another on valuation issues. Indeed, the United States bankruptcy system is generally considered the finest in the world; other countries seek to emulate the United States bankruptcy system.

Judicial valuation is the very heart of the bankruptcy enterprise. Numerous provisions of the Bankruptcy Code require judicial valuation. Contrary to Petitioner's claims, the Bankruptcy Code does not display an "aversion" to judicial valuation; neither the Bankruptcy Code nor this Court have ever required a market test for an asset's valuation in lieu of judicial valuation.

For example, the bankruptcy court must undertake a valuation to determine whether a creditor is entitled to "adequate protection" of its interest in the debtor's property under 11 U.S.C. § 361, pursuant to either 11 U.S.C. §§ 362, 363, or 364(d), and how much the adequate protection should be. This is never done through a market test. Likewise, a bankruptcy court must undertake a valuation to approve a free-and-clear sale under section 363(f)(3). Again, no market test is invoked.

More generally, bankruptcy courts must undertake valuations to determine the reasonableness of any section 363 sale or lease or to determine if a pre-petition transfer was constructively fraudulent under 11 U.S.C. §§ 544(b)

and 548. Bankruptcy courts must also undertake valuations to determine whether and the extent to which a claim is unsecured under 11 U.S.C. § 506. Likewise, confirmation of a Chapter 9 or Chapter 11 cramdown plan or a Chapter 12 or 13 plan of any sort requires the bankruptcy court to value the payments made to secured creditors to determine if their present value is equal to the allowed amount of the secured claim on the effective date of the plan or is the indubitable equivalent thereof. 11 U.S.C. §§ 901(a), 1129(b)(2)(A)(i), 1129(b)(2)(A)(iii), 1225(a)(5)(B), 1325(a)(5)(B). Absent confidence in the ability of bankruptcy courts to undertake valuations, the entire bankruptcy system falls apart.

3. Valuations in the Instant Cases Are Not in Dispute.

The facts of the instant cases show that there is no real concern over valuation issues. Petitioner did not dispute the valuation of either property. Both of Respondents' second-lien mortgages were deeply underwater. Respondent Caulkett's home was valued at $98,000 and was encumbered with a first-lien mortgage for $183,264 and a second-lien mortgage for $47,855. Caulkett Opp. Br. at 6. Likewise, Respondent Toledo-Cardona's home was valued at $77,689, but was encumbered with a first lien mortgage of $135,703 and a second-lien mortgage of $32,000. Toledo-Cardona Opp. Br. at 6.

In both cases, the bankruptcy court would have to have erred in its valuation of Respondents' properties by fifty percent for Petitioner to have been "in the money" by as much as a penny. On these valuations, Respondents' properties would have to *double* in value for Petitioner's mortgages to *ever* be back in the money.

In most situations, like these cases, there will be no question whether the second-lien mortgage is wholly underwater; valuations will not be close to the total amount due under the first-lien mortgage. In those few close cases, the parties are likely to settle rather than risk a judicial valuation. Thus, concerns about inaccurate judicial valuation are a red herring.

D. The Market Will Not Price Adversely to Judicial Lien-Stripping Because Bankruptcy Can Create Value for First-Mortgagees.

Yet another reason the market is unlikely to price adversely to the risk of judicial lien-stripping is that (counter-intuitively) bankruptcy may in fact create value for first mortgagees. The baseline against which mortgagees evaluate bankruptcy is not a world of no losses, but a world of foreclosure sales and loan restructurings. Relative to foreclosure sales and loan restructurings, bankruptcy offers a number of advantages.

First, as long as the debtor is in bankruptcy, the lender is able to receive adequate protection of

its interest in the property. 11 U.S.C. §§ 361, 362(d)(1).

Second, if the property is sold in bankruptcy rather than through a state law foreclosure sale, it is likely to result in a greater recovery for the lender. Foreclosure sales are done without marketing aside from judicial notice advertisement. Foreclosure sales also occur without a showing of the property to prospective buyers; because the property remains the borrower's until the foreclosure sale is closed, prospective buyers lack a pre-sale right of entry and inspection. The result is to depress foreclosure sale prices because of prospective buyers' informational disadvantages. A bankruptcy sale under section 363 can produce a higher sale price because the property can be marketed as if it were an arm's length private sale, with full inspection rights for potential buyers. 11 U.S.C. § 363.

Likewise, several states allow buyers a statutory post-sale right of redemption; in some states this post-sale right of redemption extends for up to two years. *See, e.g.*, Ala. Code § 6-5-248(b) (one-year right of redemption); Tenn. Code § 66-8-101 (two-year right of redemption). Post-sale statutory rights of redemption depress foreclosure sale prices because buyers cannot obtain clean title until the expiration of the statutory redemption period. A sale under section 363 of the Bankruptcy Code would not be subject to state law rights of redemption that are triggered only by state

foreclosure sales. Cutting off the statutory post-sale right of redemption increases buyer certainty of sale finality and thus sale prices.

Not only is judicial valuation central to bankruptcy, *supra*, section II.C.2., but it is a far better valuation methodology than the alternative of foreclosure sales, which this Court has recognized have an uncontroverted and uncontestable downward valuation bias. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994).

Third, as discussed in the following section, bankruptcy enables a circumvention of the principal-agent problem that can exist between mortgage lenders and their servicing agents. Because bankruptcy can actually *create* value for lienholders, they might not price adversely to lien-stripping risk.

E. Permitting Judicial Lien-Stripping Helps Overcomes Agency Problems in Mortgage Servicing.

An additional reason why the market may not price adversely to the risk of lien-stripping is that lien-stripping solves a principal-agent problem in the mortgage industry. During the 1978-1994 period, most mortgage loans were financed by depositories' balance sheet lending: banks and thrifts would make loans and hold them.[5] Since 1995, however, most residential mortgage loans are financed through securitization.[6] This means that the loans are sold to specially-created trusts that pay for the loans by issuing debt securities known as mortgage-backed securities.

Securitized loans still need to be managed on a day-to-day basis, however. Monthly invoices need to be mailed, payments collected from mortgagors and remitted to the holders of the mortgage-backed securities, payoff statements and escrow balances generated, and defaults managed. This day-to-day management of the loans is handled by entities known as mortgage servicers.[7] The servicers

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[5] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[6] *Id.*

[7] Servicers are often the original lenders. The original lenders will sell the mortgage loan, but retain the servicing rights and revenue.

function as agents for mortgage-backed securities investors, but those investors have little ability to oversee or discipline the servicers. *See* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 7, 58-63 (2012).

Servicers are paid *before* the mortgage-backed securities investors, making them essentially the senior creditors of the trusts that issue the mortgage-backed securities. *See id.* at 70. The result is that servicers' incentives are frequently not aligned with those of investors; servicers are often incentivized to foreclose on loans when a restructuring, potentially including principal reduction, would maximize value for investors. *Id.* at 5, 76; *see also* Katherine M. Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121, 126 (2008).

Lien-stripping in bankruptcy accomplishes a restructuring without consent of the servicer. While servicers may not like this, restructuring is often in the interest of the mortgage-backed securities investors, which is why the mortgage market does not price adversely to the risk of lien-stripping. Lien-stripping enables value-maximizing restructuring in the face of a principal-agent problem in loan servicing.

Beyond the empirical evidence, there are a multitude of reasons to doubt that there will be any adverse market reaction to affirming the decisions below. First, liens have been stripped off of wholly underwater second mortgages in Chapter 7 for

some time now in the 11th Circuit without there being an "enormous and unwarranted disruption of settled expectations" in markets. Pet'r's Br. at 44.

Second, liens have been stripped off of wholly underwater second mortgages in Chapter 13 for some time now in eight circuits, *see* section II.B, *supra*, without there being an "enormous and unwarranted disruption of settled expectations" in markets. Pet'r's Br. at 44.

Third, liens have always been stripped off of wholly and partially underwater loans of almost all types in Chapter 11. This has never caused any sort of market disruption, as markets are capable of pricing for this risk.

Indeed, neither Petitioner nor its amici are able to point to *any* sort of evidence of market disruption caused by lien-stripping. There is no reason to think that the U.S. housing finance market—one of the largest and most liquid markets in the world—cannot easily adjust to a very particularized type of bankruptcy risk on wholly underwater second-lien mortgages, particularly because the type of loan at issue simply is not made any more, as discussed in Section III, below.

F. Petitioner's Litigation to Protect Utterly Worthless Liens is Puzzling.

Given how deeply underwater the second mortgages are in the instant cases, it is puzzling why Petitioner is litigating the issue. Even if Petitioner were to prevail before this Court, its

liens would still be deeply underwater. Florida real estate prices would have to *double* for either of Petitioner's mortgages to even "break the waterline." If the Respondents' first mortgage lenders were to foreclose before such an astonishing market rebound, Petitioner would have no recovery from its mortgages. The primary effect of a favorable ruling for Petitioner would not be the preservation of the value of these worthless liens; rather, it might allow Petitioner and similarly situated banks to delay loss recognition on their bad loans.

Banks like Petitioner are subject to minimum regulatory capital requirements based on the value of the bank's assets. *See* 12 U.S.C. § 1831o (requiring minimum capital standards); 12 C.F.R. § 3 (regulatory implementation of capital standards for national banks). A borrower's bankruptcy filing can trigger regulatory accounting rules that require a bank to write down the loan on its books. Federal Financial Institutions Examination Council, *Uniform Retail Credit Classification and Account Management Policy*, 65 Fed. Reg. 36903, 36904 (June 12, 2000). If a bank's net asset value falls too low, the bank will have to raise additional capital to comply with regulatory capital requirements and thus dilute its existing shareholders' equity. To the extent that loss recognition can be delayed, however, losses can be offset by retained earnings, thereby avoiding the need to raise additional capital and dilute existing shareholders.

Petitioner's financial situation illuminates the magnitude of this effect. As of the end of the third quarter of 2014, Petitioner held over $87 billion in junior mortgages.[8] This is the largest portfolio of junior mortgages of any financial institution in the United States,[9] and accounts for nearly 6% of Petitioner's assets. *Id.* Seventeen percent of these junior mortgages were underwater. *See* Bank of America, Quarterly Report (Form 10-Q) 92 & tbl. 37, 171 (Nov. 6, 2014). As of the fourth quarter of 2014, Petitioner had loss reserves equal to 3.95% of its junior mortgage portfolio, meaning it is carrying its junior portfolio at over 96 cents on the dollar. *Id.* at 87. *See also* Been et al., 9 N.Y.U. J. L. & Bus. at 95 (observing the same in 2011).

If debtors in all circuits could strip off wholly underwater junior liens, then Petitioner and similarly situated banks might have to recognize losses on much more of their wholly underwater junior mortgages sooner than they otherwise would. In other words, this case will not affect the "settled expectations" of markets, Pet'r's Br. at 44, but whether Petitioner and similarly situated banks will have to dilute their shareholders' equity.

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[8] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[9] Kathleen Howley & Dankin Campbell, *Bank of America Faces Bad Home Equity Loans: Mortgages*, Bloomberg Business, Apr. 18, 2012.

III. The Second-Lien Mortgage Lending Market Is Near Dead and Should Not Be Resuscitated.

There is further cause to believe that the economic effect of permitting lien-stripping for wholly underwater second mortgages is likely to be minimal: since the implosion of the housing bubble, second-lien loans with high CLTVs are rarely (if ever) made. Second-lien mortgages in general "have now all but disappeared." Laurie Goodman et al., *Where Have All the Loans Gone? The Impact of Credit Availability on Mortgage Volume*, 20 J. Structured Fin. 45, 46 (2014); *see also* Lee et al., *A New Look at Second-liens*, 569 Fed. Reserve Bank of N.Y. Staff Rep. 7 at 28.

There were less than 200,000 second-lien mortgages of all types originated in 2013.[10] In contrast, during the height of the bubble nearly a decade ago, there were over 2.8 million second-lien mortgages made. *See* Robert B. Avery et al., *The 2006 HMDA Data*, 93 Fed. Res. Bulletin A73, A82 (Dec. 2007).

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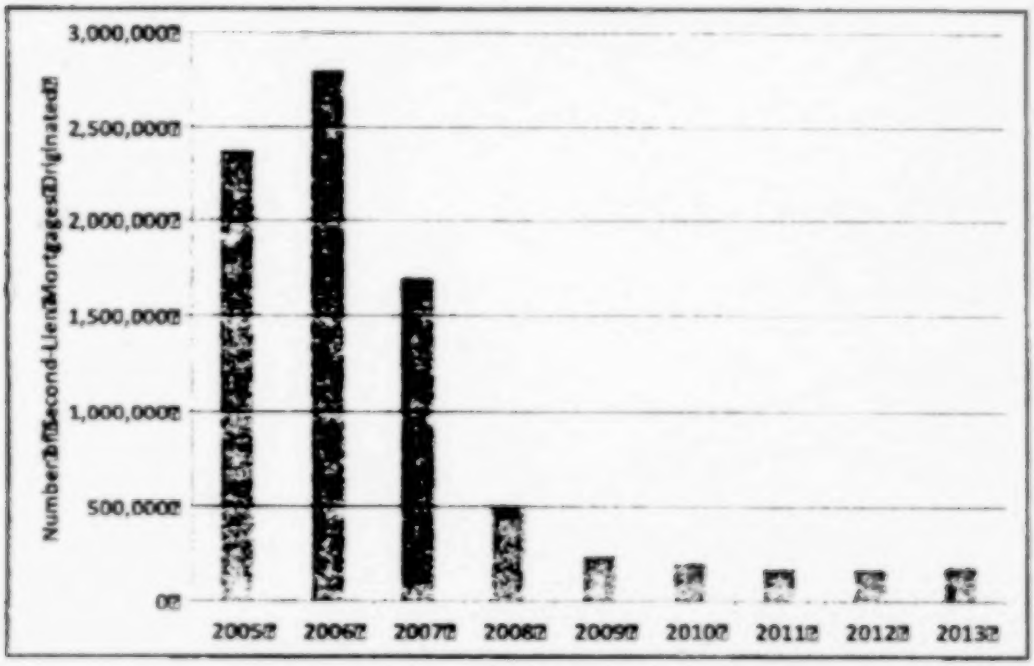
[10] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

Figure 2. Number of Second-Lien Mortgages Originated by Year[11]



Of the second mortgages originated in 2013, 38% were home improvement loans, which generally have low CLTVs. In contrast only 19% of the second mortgages originated in 2005 or 2006 were home improvement loans; most were piggyback purchase money loans. High-CLTV second-lien lending is a creature of the past. *See* Bonnie Sinnock, *Second Liens Grow Again as Other Mortgage Lending Dwindles*, Nat'l Mortg. News, July 31, 2014.

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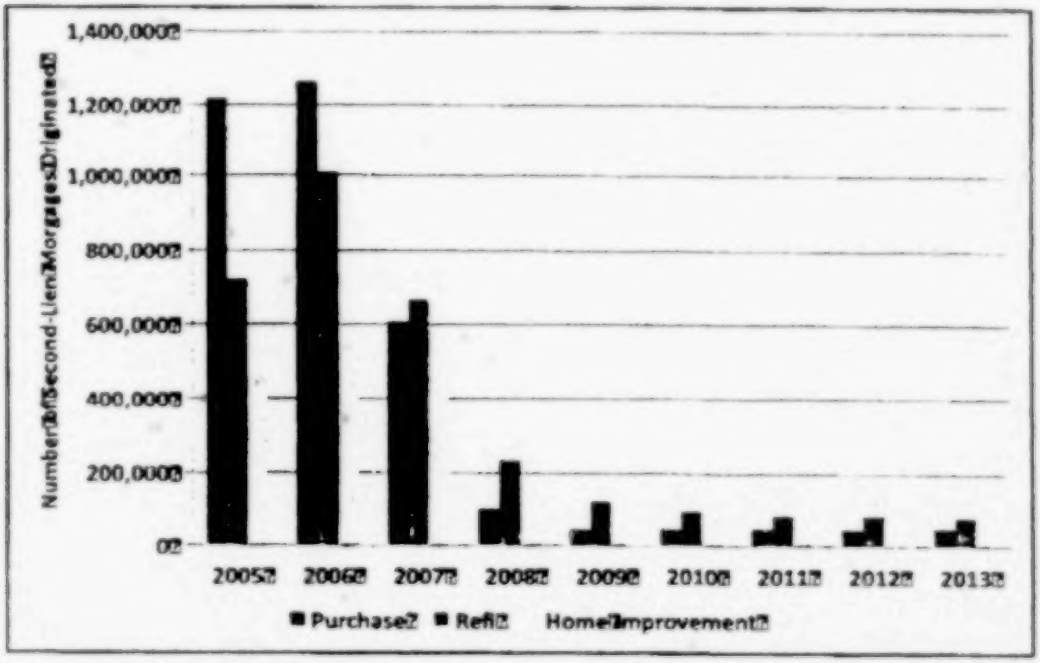
[11] Underlying data sources and step-by-step computations available at: http://instituteforpublicrepresentation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

Figure 3. Number of Second Lien Mortgages Originated by Year by Loan Purpose[12]



The situation in the instant cases is a singular product of the 2003-2007 housing bubble. Subsequent regulatory and market changes mean that high CLTV second-lien mortgages are rarely made any more and are unlikely to be in made in the future.

The high CLTV second-lien mortgage market has disappeared because of a combination of regulatory and market conditions. New mortgage market regulations make it difficult to make high

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[12] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

CLTV second-lien mortgages. Current law prohibits the making of mortgage loans without verification of the borrower's ability to repay the loan. *See* 15 U.S.C. § 1639c. While the regulatory implementation of the ability to repay requirement does not have a LTV component, it will effectively limit most high CLTV lending because high CLTV lending correlates with other risk characteristics covered by the implementing regulation, such as high debt-to-income ratios, lack of full amortization, and prepayment penalties.

Beyond regulation, there is no financing for making high CLTV second mortgage loans. The mortgage market's collapse in 2007 and the following years severely chastened mortgage lenders and mortgage investors. There simply is no financing for high CLTV seconds. Banks do not want to incur the risk on their balance sheets, and Fannie Mae and Freddie Mac are prohibited from purchasing high CLTV seconds.

The other possible financing channel, private-label securitization, which provided the high-octane financing for the housing bubble, has been virtually moribund since 2008. In 2006, private-label securitization funded 43% of all residential mortgage originations in the United States or more than $1.17 *trillion* of mortgages per year. [13] In contrast, in 2014, private label securitization funded a mere $5.58 *billion* of mortgage originations.[14] Over 99.5% of the private-label securitization market has disappeared since the bubble. Only 7,250 mortgages nationwide were funded by private-label securitization in 2014.[15]

The lack of financing for high CLTV second mortgages is unlikely to change in the foreseeable future because there is no market appetite for the credit risk involved in such lending. It is hard to conceive of super-risky mortgages like the ones the Petitioner made to Respondents being made in today's more sober lending environment. This Court should not give succor to the revival of such destructive lending.

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[13] Underlying data sources and step-by-step computations available at: http://instituteforpublic representation.org/wp-content/uploads/2015/02/Data-sources-and-computations.pdf.

[14] *Id.*

[15] *Id.*

CONCLUSION

For the aforementioned reasons, Amicus Curiae Adam J. Levitin respectfully submits that the instant cases should not be controlled by *Dewsnup v. Timm* and that the 11th Circuit's judgments should be affirmed.

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v.

DAVID B. CAULKETT, RESPONDENT.

BANK OF AMERICA, N.A., PETITIONER,

v.

EDELMIRO TOLEDO-CARDONA, RESPONDENT.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF LOAN SYNDICATIONS AND TRADING ASSOCIATION, AMERICAN BANKERS ASSOCIATION, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, AND THE CLEARING HOUSE ASSOCIATION L.L.C. AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether Section 506(d) of the Bankruptcy Code authorizes a bankruptcy court to compel the holder of a mortgage to relinquish the mortgaged property to the debtor, free of the lien, without full payment of the debt.

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INTEREST OF *AMICI CURIAE* [1]

The Loan Syndications and Trading Association ("LSTA") is a financial trade association whose mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants. Its interest in these cases lies in promoting sensible and effective rules for the liquidation and collection of secured loans. Because its members frequently purchase debt in the secondary market, often secured by an inferior lien, their interest in a reasoned resolution of this problem is paramount. Moreover, as a nationwide group with members under the jurisdiction of virtually every federal court of appeals, LSTA has a unique interest in ensuring regularity and predictability throughout the circuits, and especially in uniform rules that promote efficient bankruptcy administration.

The American Bankers Association ("ABA") is the largest national trade association of the banking industry in the country. It represents banks and holding companies of all sizes in each of the fifty states and the District of Columbia, including community, regional, and money center banks. The ABA also represents savings associations, trust companies, and savings banks. ABA members hold approximately 95% of the United States banking industry's domestic assets. The ABA frequently appears in litigation, either as a party or amicus curiae, in order to protect

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[1] This brief was not authored in whole or in part by counsel for a party. No person other than the *amici* made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

and promote the interests of the banking industry and its members.

The Securities Industry and Financial Markets Association ("SIFMA") is a member-driven association that brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to develop policies and practices that strengthen financial markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA is the U.S. regional member of the Global Financial Markets Association. SIFMA's interest in the stability and availability of capital gives it a strong interest in cases, like this one, that have the potential for adverse systemic impact on commercial lending markets.

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound, and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing, and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2

trillion each day, representing nearly half of all automated clearing house, funds transfer, and check image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

These cases present the question whether Section 506(d) gives a bankruptcy court the authority to compel the holder of a mortgage to relinquish property to the debtor, free of the lien, without payment in full of the debt. Since this Court's rejection of an almost identical claim twenty years ago in *Dewsnup v. Timm*, 502 U.S. 410 (1992), a framework of reliance built upon that decision has spread throughout the Nation's financial markets. To overturn that framework now – more than two decades later – would destabilize markets still recovering from the economic stresses of the last several years. *Amici* have a direct interest in the stability of that framework; we hope this brief will help the Court understand the disruption to commercial expectations that would follow a reversal of course.

SUMMARY OF ARGUMENT

1. Inferior liens are now, and have been for more than a century, an integral part of the Nation's mortgage lending markets. Although the particular cases before the Court involve inferior liens on residential property, inferior liens are vital to commercial markets as well. The decision in these cases inevitably will ripple through that broader market.

The lenders that advance funds in that market have operated for decades against the backdrop of this Court's decision in *Dewsnup*. Taken on its own terms, the analysis of *Dewsnup* applies as directly to inferior liens as it does to the first lien at issue in *Dewsnup*

itself. Indeed, a contrary rule in this situation would be even more remarkable than it would have been in *Dewsnup*, because it would allow a borrower to retain collateral without paying ***anything*** to the lender. A ruling that validated "lien-stripping" in this context would cause marked and unanticipated disruption to a central sector of our Nation's still-fragile commercial and consumer lending markets.

2. As long as the Nation has had bankruptcy laws, their basic premise has been that "liens pass through bankruptcy unaffected." The details of those laws have changed substantially as the role of the bankruptcy process in managing financial distress has grown, but with a single exception (promptly held unconstitutional by this Court), no statute, outside the reorganization context, has ever compelled a mortgage lender to surrender its collateral to the debtor while the loan remains unpaid. The argument that Section 506 of the Bankruptcy Code implicitly allows the bankruptcy court to strip off a creditor's lien – based solely on the result of a current appraisal, and without the procedural protections that cabin the reorganization chapters – is so foreign to traditional practice that it cannot be countenanced.

ARGUMENT

I. Stripping off Inferior Liens Would Disrupt a Large Sector of the Commercial Lending Market That Justifiably Has Relied on This Court's Interpretation of the Bankruptcy Code.

There is nothing novel or unusual about taking multiple liens to secure different loans on the same piece of real estate. To the contrary, it has been a common practice in this country for more than a

century. This Court's own decisions provide a glimpse of that practice. *E.g.*, *Penn v. Calhoun*, 121 U.S. 251 (1887) (adjudicating priority of second lien against proceeds of a foreclosure sale); *Louisville, E. & St. Louis Railway v. Wilson*, 138 U.S. 501 (1891) (adjudicating propriety of receiver deducting expenses from foreclosure proceeds due to holder of second lien). More broadly, the ubiquity of inferior liens in the 19th Century is plain from the pervasive discussion of the subject in the treatises of the day, which reference ***hundreds*** of reported opinions resolving disputes between competing lienholders.[2] Inferior liens are neither novel nor innovative; they are a cornerstone of lending practice.

Today, inferior liens play a crucial role in any number of markets. These cases involve a second lien in the context of a residential mortgage loan, a type of

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[2] *E.g.*, Charles T. Boone, Law of Mortgages of Real and Personal Property §§ 66-72 (1886) (discussing effects of registration, notice, and agreement on priority between competing mortgage lenders); William Richard Fisher, The Law of Mortgage as to the Redemption, Foreclosure, and Sale in Equity of Property with the Law of the Priority of Incumbrancers ch. vii (1857) (discussing priority between competing mortgage lenders); Leonard A. Jones, A Treatise on the Law of Mortgages of Real Property chs. xii-xiii (5th ed. 1894) (discussing effects of registration and notice on priority between competing mortgage lenders); Darius H. Pingrey, Treatise on the Law of Mortgages of Real Property chs. xviii, xxvi, (2nd ed. 1893) (discussing effects of registration on priority between competing mortgage lenders and the right of a junior lienholder to be subrogated to the rights of senior lienholder); 1 Charles Hasting Wiltsie & James A. Kerr, A Treatise on the Law and Practice of Foreclosing Mortgages on Real Property, and of Remedies Collateral Thereto, with Forms ch. vii (1897) (discussing procedures for foreclosures on property burdened by junior liens).

loan that is not at all unusual.[3] But inferior liens are common in the commercial arena as well. Notwithstanding the capital constraints related to the recent economic downturn, lenders use inferior liens to protect billions of dollars of new loans each year.[4] More than $40 billion of such loans are presently outstanding.[5] The backdrop against which the Court considers these cases should include the commonplace use of inferior liens in the commercial context as well as the residential context directly at issue. The stakes of these cases are high, for their resolution will affect lending decisions of both kinds.

No lender reasonably could have doubted the application of *Dewsnup* to inferior liens – underwater or not. As a glance at the *Dewsnup* opinion demonstrates, neither a lien's priority nor the value of the collateral that secures it has any relation to the logic that grounded this Court's opinion in *Dewsnup*. The Court explained that Section 506(d) invalidated liens only when the underlying claims were disallowed under Bankruptcy Code § 502: "[P]etitioner [can not] 'strip down' respondent's lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to § 502." *Dewsnup*, *supra*, 502 U.S. at 417. Thus, lenders had every reason to rely on the Court's observation "that the creditor's lien stays with the real property until the foreclosure. That is what was

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[3] *See* Federal Reserve Statistical Release Z.1, Financial Accounts of the United States tbl. L-218, ll. 1, 23, at 107 (Dec. 11, 2014) (data on second liens in the residential market).

[4] *E.g.*, Steve Miller, *Amid Quest for Yield, 2nd-Lien Leveraged Loan Issuance Soars*, forbes.com, March 14, 2014, *available at* http://www.forbes.com/sites/spleverage/2014/03/14/amid-quest-for-yield-2nd-lien-leveraged-loan-issuance-soars/.

[5] Standard & Poors, *Leveraged Commentary and Data* (2015).

bargained for by the mortgagor and the mortgagee." *Id.* In sum, under the reasoning of the *Dewsnup* Court, the only criterion necessary for a lien to survive the application of Section 506 is the allowance of the underlying claim. The value an appraiser finds for the collateral at the time of bankruptcy is wholly irrelevant.

Indeed, from the perspective of commercial expectations, the proposed intrusion on the lienholder's interest in these cases would be even more remarkable than the intrusion that *Dewsnup* rejected. The "stripping down" at issue in *Dewsnup* would have left the lien in place, permitting a foreclosure if the borrower failed to pay the reduced debt. By contrast, the "stripping off" that respondents seek would invalidate petitioner's liens ***entirely*** without ***any payment at all***.

The destabilizing effects of an adverse decision in these cases on the $40 billion-dollar market for commercial loans secured by inferior liens are apparent. Lenders to businesses with volatile assets would need to reckon with the likelihood that their liens could be stripped off at any point in time when the value of the collateral fell far enough to justify an appraisal by a bankruptcy judge that would leave their loan wholly "underwater" – preventing any recovery on the loan even if the value of the collateral recovered (or if the appraisal simply was mistaken). Because inferior-lien loans, by definition, reach closer to the margin of collateral value than first-lien loans, concerns about limitations on the customary remedies of the lenders that rely on them are even more chilling than they are in the first-lien context.

Although these cases involve Chapter 7 filings, the effects of lien-stripping under Section 506(d) on the

reorganization of troubled businesses would be even starker. To be sure, a bankrupt firm has the ability in a Chapter 11 plan to limit a secured lender's recovery to the value of its collateral. But Chapter 11 sanctions such a limitation only in the context of the highly structured process for plan confirmation, which provides numerous substantive and procedural protections for the lender. *See, e.g.*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2069-73 (2012). Automatic lien stripping under Section 506(d), by contrast, would allow the debtor immediately to eliminate the rights of the inferior lienholder, solely on the basis of a judicial valuation, without any recourse to the market tests this Court has found so central to the Chapter 11 process. *See Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999). In a context where small mistakes in the valuation of collateral could cost lenders tens of millions of dollars, the Court should hesitate before overturning the justifiably long-settled expectations of the affected parties.

II. The Bankruptcy Laws of this Country That Preceded the Bankruptcy Code of 1978 Never Compelled the Holder of a Mortgage to Surrender the Mortgaged Property to the Bankrupt While the Debt Remains Unpaid.

The Court has emphasized that a "sense of history is needed to appreciate" the context of the Bankruptcy Code. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994). Accordingly, we thought it would be useful to the Court's deliberations to discuss the treatment of liens under the various federal bankruptcy statutes that predated the adoption of the Bankruptcy Code of 1978. As the discussion below demonstrates, none of

those statutes gave bankruptcy courts the power to compel a lienholder – holding a senior lien or a junior lien, regardless of the collateral's value – to release its collateral to the debtor while its loan remained unpaid; this Court promptly invalidated the only statute that purported to grant that power. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 581-82 (1934).[6] Rather, as in so many other areas, federal bankruptcy legislation has deferred to state law for the definition of the rights and interests of secured creditors. *See Butner v. United States*, 440 U.S. 48 (1978). Under state law, of course, a creditor's lien is discharged only by repayment of the debt or a foreclosure sale.

A. The Temporary Bankruptcy Acts of the Nineteenth Century Did Not Impair the Rights of Secured Creditors

Before adoption of the first permanent bankruptcy act in 1898, Congress passed temporary bankruptcy statutes in 1800,[7] 1841,[8] and 1867,[9] each in response to a national financial crisis. *See Louisville Joint*

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[6] Before the adoption of the original Frazier-Lemke Act (ch. 869, 48 Stat. 1289 (1934), held unconstitutional in *Louisville Joint Stock Land Bank*, *supra*), "none [of our national bankruptcy acts had] sought to compel the holder of a mortgage to surrender to the bankrupt either the possession of the mortgaged property or the title, so long as any part of the debt thereby secured remained unpaid." *Id.* at 581-82.

[7] Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed by Act of Dec. 19, 1803, ch. 6, 2 Stat. 248).

[8] Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed by Act of Mar. 3, 1843, ch. 82, 5 Stat. 614).

[9] Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (repealed by Act of June 7, 1878, ch. 160, 20 Stat. 99).

Stock Land Bank, *supra*, 295 U.S. at 581-82.[10] Although the drafting of the statutes differed markedly, none had any substantive effects on liens.[11]

First, the 1800 Act provided: "[N]othing contained in this act, shall be taken, or construed to invalidate, or impair any lien existing at the date of this act, upon the lands or chattels of any person who may have become a bankrupt." § 63, 2 Stat. at 36. Similarly, the 1841 Act provided: "[N]othing in this act contained shall be construed to annul, destroy, or impair * * * any liens, mortgages, or other securities on property, real or personal, which may be valid by the laws of the States respectively, and which are not inconsistent with the provisions of the [sections of the statute describing preferences and disallowed claims]." § 2, 5 Stat. at 442. Finally, the 1867 Act provided: "[N]o mortgage of any vessel or of any other goods or chattels, made as security for any debt or debts, in good faith and for present considerations and otherwise valid, and duly recorded, pursuant to any statute of the United States, or of any State, shall be invalidated or affected hereby." § 14, 14 Stat. at 523.[12]

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[10] *See generally* Charles Warren, Bankruptcy in United States History 10-126 (1935); Charles Tabb, *The History of the Bankruptcy Laws in the United States*, 5 ABI L. Rev. 5, 14-15, 16-21 (1995); Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 Case Western Res. L. Rev. 319, 343-48, 360-65, 373-78 (2013).

[11] *See Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 582 (footnote omitted) ("The earlier bankruptcy acts created some exemptions of unencumbered property; but none had attempted to enlarge the rights or privileges of the mortgagor as against the mortgagee.").

[12] Although the language of the 1867 Act protecting liens was less explicit than the language of the earlier statutes, the courts recognized that "§ 14 of the bankrupt law of 1867 * * * is

The courts took those statutes at face value, applying them most frequently in disputes over whether a particular interest was sufficiently choate to amount to a lien. *E.g.*, *Ex parte Foster*, 9 Fed. Cas. 508 (C.C.D. Mass. 1842) (per Story, J.) (concluding that prejudgment attachment did not create a lien for purposes of the 1841 Act); *Waller's Lessee v. Best*, 44 U.S. (3 How.) 111, 120 (1845) (per Taney, C.J.) (Because delivery of a writ of execution to a sheriff perfects a lien under Kentucky law, "the creditor is not deprived of this lien by an act of bankruptcy on the part of the debtor committed [later]."). There was never any doubt that the liens remained unimpaired by the bankruptcy filing. To the contrary, the cases are replete with descriptions of the continuing robustness of the lien after bankruptcy; the underlying theme is that the bankruptcy process takes the liens as it finds them under applicable State law.[13]

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equivalent in effect to a provision in express terms for [liens'] preservation – such as was made * * * in the bankrupt law of 1841." *Leighton v. Kelsey*, 57 Me. 85, 90 (1869). Indeed, the *Leighton* court thought the principle calling for the preservation of liens was so clearly defined in earlier cases that it professed that "one can enter the same field now only as a disciple and copyist." *Id.*

[13] *E.g.*, *Norton's Assignee v. Boyd*, 44 U.S. (3 How.) 426, 436 (1845) (per Taney, C.J.) ("It is quite clear that the liens and mortgages which are valid under the state law must be protected by the District Court of the United States sitting in bankruptcy, and it will not be pretended that the creditor * * * would not have been entitled, under any and all circumstances, to the proceeds of that property to satisfy [the debt]"); *Bellows v. Jenness*, 48 U.S. (7 How.) 612, 622 (1849) ("[T]he words of the proviso [protecting liens] are of the most general and expansive character; they are equivalent to a saving of all liens * * * from any construction of the act [of 1841] that shall in any wise annul, destroy, or impair them"); *Bruner v. Sherley & Sherley*, 27 Miss. (5 Cushm.) 407,

Although litigation under the 1800 Act seems to have been sparse, by the time jurists confronted cases under the 1841 Act, they recognized a crisp distinction between the *in personam* liability of the bankrupt (discharged in the bankruptcy proceeding) and the *in rem* liability of the collateral (which passed through the bankruptcy unaffected). The following discussion from the Mississippi Supreme Court, considering the effect of a bankruptcy discharge on a mortgage reflected in a deed of trust, is illustrative:

> The first question to be settled is, whether the discharge of the appellant from the debt, by his certificate as a bankrupt, extinguished the deed in trust.
>
> It is insisted, on his behalf, that the deed was but a mere incident to the debt, and that whatever discharged the debt necessarily destroyed the deed, because the security could not exist where the debt, which was its foundation and support, was discharged. * * * *
>
> [That] objection is fully met by the second section of the bankrupt act of Congress of 1841, which [makes] it manifest that, while the privilege was granted to the debtor to be personally discharged from the debt, any security which the creditor might have, consisting of a lien on property, was left in as full force as though the debtor had never been

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408-09 (1854) (explaining that despite a discharge under the 1841 Act, liens "were continued in full operation"); *Reed v. Bullington*, 49 Miss. 223, 228 (1873) ("The bankrupt law, as we have seen, preserves the lien of a creditor in full vigor * * * ").

> discharged from the debt, for the security of which the lien was made.

Bush v. Cooper, 26 Miss. (4 Cushm.) 599, 611-12 (1853). Although the statutory description of the discharge in the 1841 Act was broad, courts concluded without exception that the bankruptcy discharge could have no effect whatsoever on the continued validity of the lien.[14]

By the time of the 1867 Act, the topic became a regular feature of this Court's docket. Again, the Court started from the premise that the assignee in bankruptcy (which held the estate of the bankrupt) stepped into the debtor's position with respect to preexisting liens under applicable State law: "Whatever the bankrupt could do to make the assigned property available for the general creditors [the assignee] may do, *but nothing more*, except that he may sue for and recover * * * fraudulent conveyances." *Dudley v. Easton*, 104 U.S. (14 Otto) 99, 103 (1881)

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[14] *E.g.*, *Bellows*, *supra*, 48 U.S. (7 How.) at 623 ("[T]o give full effect to all the provisions of the act [of 1841], the bankrupt's certificate must be made to operate as a discharge of his person and future acquisitions, while, at the same time, the mortgagees * * * shall be permitted to have their satisfaction out of the property mortgaged * * * "); *Kittredge v. Warren*, 14 N.H. 509, 515 (1844) ("[I]f the attachment [lien] is saved by the act [of 1841], the certificate [of discharge] obtained under the act ought not to destroy the attachment."); 1 Peleg Chandler, The Bankrupt Law of the United States, with an Outline of the System § 8, at 16 (1842) (explaining that a lien "within the meaning of the law * * * would not be affected by the subsequent decree of bankruptcy or discharge of the debtor"); *Leighton*, *supra*, 57 Me. at 89 ("[T]he provisions in the bankrupt act [of 1867] are not to be so construed as to prevent the rendition of [a judgment to perfect the lien] in all cases where [the lien was acquired more than four months before the bankruptcy proceeding].").

(per Waite, C.J.) (emphasis added); *see Yeatman v. Savings Institution*, 95 U.S. (5 Otto) 764, 767 (1877) (per Harlan, J.) ("The established rule is that the assignee takes the title subject to all equities, liens, or incumbrances, whether created by operation of law or by act of the bankrupt, which existed against the property in the hands of the bankrupt.").[15]

As it happens, litigation under the Act of 1867 afforded the Court an opportunity to consider the specific question at issue here – whether a bankruptcy discharge vitiates not only the debt but also the lien given to secure it. The issue was squarely presented in the oft-cited decision in *Long v. Bullard*, 117 U.S. 617 (1886). The debtor in that case had filed for bankruptcy under the Act of 1867, and retained ownership of his homestead after that proceeding. When the holder of a pre-bankruptcy mortgage sought to foreclose, Long argued (much like respondents) that the bankruptcy discharge had vitiated not only the debt but also the lien. When the lower court rejected that claim, the Court concluded that "there cannot be a doubt of the correctness of the decision." The Court offered the matter-of-fact explanation that Bullard's

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[15] *See also, e.g., In re Hambright*, 11 Fed. Cas. 314, 315 (W.D.S.C. 1869) ("What is meant by the expression 'estate of the bankrupt'? Evidently such property and rights of the bankrupt as the bankrupt act [of 1867] vests in the assignee. The assignee can take nothing more than the bankrupt himself had in any case, except the case of a fraudulent conveyance."); *Mattocks v. Baker*, 2 F. (2 Hask.) 455, 455 (D. Me. 1880); Orlando Bump, The Practice in Bankruptcy, with the Bankrupt Law of the United States as Amended § 20, at 375 (5th ed. 1872) ("When it speaks of the estate of the bankrupt, it means such estate with all the incumbrances existing upon it at the time of the bankruptcy * * * ").

"security was preserved notwithstanding the bankruptcy of his debtor." *Long*, *supra*, 117 U.S. at 621.

B. The Bankruptcy Act of 1898 Left Liens Unimpaired.

Although the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, wrought great changes in bankruptcy practice,[16] it did not alter the traditional preservation of liens. Section 67d codified the baseline rule:

> Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act.

30 Stat. 564. The language was plain and direct, and courts understood it as Congress wrote it. "Section 67d * * * declares that liens given or accepted in good faith and not in contemplation of or in fraud upon this act, shall not be affected by it." *City of Richmond v. Bird*, 249 U.S. 174, 177 (1919).[17]

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[16] *See, e.g.*, Lubben, *supra*, 64 Case Western Res. L. Rev. at 385-90 (summarizing important changes introduced in 1898); Tabb, *supra*, 3 ABI L. Rev. at 23-26 (same).

[17] Like its decisions interpreting the 1867 Act, the Court's discussion of the 1898 Act emphasized the principle that the trustee's position against secured creditors was no better than the debtor's position before the bankruptcy filing. *E.g.*, *Everett v. Judson*, 228 U.S. 474, 479 (1913) (discussing intent "to fix the line of cleavage with reference to the condition of the bankrupt estate as of the time at which the petition was filed"); *York Mfg. Co. v. Cassell*, 201 U.S. 344, 352 (1906) ("Under the provisions of the bankrupt act the trustee in bankruptcy is vested with no better title or right to the bankrupt's property than belonged to the bankrupt at the time when the trustee's title accrued. * * * * The

As with the earlier acts, the 1898 Act rested on a fundamental distinction between the discharge of the debtor's personal liability and the preservation of the liens given to secure the debtor's obligations. That distinction was immediately apparent to the earliest courts to address the new statute:

> [D]ebts which, by their nature, are provable in bankruptcy, are released by a discharge in bankruptcy; that is to say, a discharge in bankruptcy releases the bankrupt from a provable debt * * * and takes away the creditor's right to proceed against him in personam. But * * * such a discharge does not affect a lien on the property of the bankrupt * * * , provided the lien is otherwise valid. A fair construction of the bankrupt act of 1898 leads to the conclusion that the discharge in bankruptcy * * * released the debt secured by the mortgage so far as to enforcement by this creditor in a personal action against [the debtor], but that discharge in no way affected the lien which [the lender] held on the property described in the mortgage.

Evans v. Rounsaville, 42 S.E. 100, 101-02 (Ga. 1902).

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trustee * * * stands in the shoes of the bankrupt, and, as between them, he has no greater right than the bankrupt."); *Thompson v. Fairbanks*, 196 U.S. 516, 526 (1905) (trustee takes "the property of the bankrupt * * * in the same plight and condition that the bankrupt himself had it"); *Hewit v. Berlin Machine Works*, 194 U.S. 296, 302 (1904) ("The present act, like all preceding bankrupt acts, contemplates that a lien good at [the time of filing] as against the debtor and as against all of his creditors shall remain undisturbed.").

The point was so central to operation of the Act that the first edition of Collier's treatise on bankruptcy devoted a separately headed section to it:

> **Discharge Releases Only the Personal Liability.**—Nothing but the bankrupt's personal liability is released by the discharge. Liens upon his [*sic*] property are in no way affected. Whatever their character if they are valid by the laws of the State and not rendered void by the provisions of * * * the bankruptcy act, the bankrupt's discharge will not prevent their enforcement. Thus, in actions to foreclose mortgages the discharge may be pleaded as a defense to the demand for a judgment for any deficiency which may exist, but not as a bar to the foreclosure proceedings.

2 The Laws of Bankruptcy and the National Bankruptcy Act of 1898, ch. 3, § 17, at 155 (W.M. Collier enl. ed. 1899) [hereinafter Collier (1st ed.)].[18]

C. The Chandler Act of 1938 Had No Substantive Effect on Liens.

Bankruptcy practice underwent another major revision with the adoption of the Chandler Act of 1938,

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[18] For a similar contemporaneous viewpoint, see, *e.g.*, 1 Edwin C. Brandenburg & William H. Oppenheimer, Brandenburg on Bankruptcy § 1532, at 1121 (4th ed. 1917).

> Valid and existing liens on specific property or trusts therein securing a debt are not impaired by the discharge.
>
> A discharge in bankruptcy releases the bankruptcy from a provable debt * * * and takes away the creditor's right to proceed against him in personam, but it does not affect a lien on his property * * * provided it is otherwise valid.

ch. 575, 52 Stat. 840, which included a complete recrafting of the provisions related to liens.[19] Again, those changes left intact the principle that a lender cannot be compelled to relinquish its collateral to the borrower until the debt is repaid.[20]

Two provisions of the Chandler Act are relevant. The first is Section 67a, the successor to section 67d of the 1898 Act. Where the drafters of the 1898 Act had made the affirmative statement that the statute had no effect on liens, Section 67a of the Chandler Act protected liens indirectly, by limiting the statute's effects on liens to those obtained "in fraud of the provisions of this Act," Chandler Act § 67a(1), 52 Stat. at 875-76. All agree that the revised drafting "had no substantive effect," *Dewsnup v. Timm*, 502 U.S. 410, 418 n.1 (1992). Rather, the section was reorganized because "the draftsmen of the 1938 Act desired generally to specify only what should be *invalid*." *Id.* (quoting 4B *Collier on Bankruptcy* ¶ 70.70, at 771 (J Moore 14th ed. 1979) (emphasis of *Collier*). As Justice Frankfurter explained, section 67d "was omitted in the

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[19] For overviews of the "comprehensive" revisions made by the Chandler Act, see, *e.g.*, Tabb, *supra*, 3 ABI L. Rev. at 29-30; Lubben, *supra*, 64 Case Western Res. L. Rev., at 385-90.

[20] That is not to say that the 1898 Act left liens unaffected. The statute had a variety of procedural effects on secured creditors. Most obviously, the bankruptcy proceeding stayed all litigation against the debtor, thus bringing to a halt any collection or foreclosure under state law. *See* Bankruptcy Act of 1898 § 11, 30 Stat. at 549; Collier (1st ed.), *supra*, ch. 3, § 11, at 100-14. Similarly, the bankruptcy court also had considerable control over the processes for assessing validity of liens, determining their amount, and liquidating the collateral, at least if the creditor chose to participate in the proceeding. *See Isaac v. Hobbs Tie & Timber Co.*, 282 U.S. 734, 737-39 (1931).

1938 revision because its wording permitted inferences that by negative implication it disallowed certain liens not otherwise invalidated by the Act, and because the substance of the provision was thought to be preserved in other sections—not because of disapproval in policy." *Simonson v. Granquist*, 389 U.S. 38, 43 (1962) (dissenting opinion).[21]

The most important innovation of the Chandler Act's treatment of liens was the introduction of new Chapters X, Chandler Act § 101 et seq., 52 Stat. at 883-905, and XI, Chandler Act § 301 et seq., 52 Stat. at 905-16.[22] Those provisions, the predecessors of the modern Code's Chapter 11, 11 U.S.C. § 1101 *et seq.*, authorized plans of reorganization that could alter the rights of creditors. *See* Chandler Act § 216(1), 52 Stat. at 895-96 (permitting the inclusion "in respect to creditors * * * , secured or unsecured, * * * [of] provisions altering or modifying their rights"). Because those provisions applied only in plans of reorganization, they would not have compelled a release to the debtor itself; then as now, the absolute priority rule would compel the elimination of any

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[21] *See Goggin v. Division of Labor Law Enforcement*, 336 U.S. 118, 126-27 (1949) (discussing "the general purpose of Congress [in adopting the Chandler Act] to safeguard interests under liens perfected before bankruptcy"); *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (5th Cir. 1949).

[22] The Chandler Act's provisions for plans of reorganization were not entirely novel. Congress had amended the Bankruptcy Act of 1898 five years earlier to permit "compositions" that affected the rights of secured creditors. *See* Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1467. *See generally Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 586 n.16 (discussing those provisions). Those provisions, however, authorized no impairment of the unconsenting holder of a mortgage lien. *See id.*, 295 U.S. at 585-86.

equity interest of the original debtor in any case that impaired the interest of an unconsenting secured creditor.[23] Thus, although it was more intrusive than its predecessors, the Chandler Act did not go so far as to compel a creditor to relinquish its collateral to its borrower until the loan was repaid. More fundamentally, as with present-day Chapter 11, the Chandler Act permitted modification of a secured creditor's lien only upon compliance with the procedural and substantive protections afforded by a plan; it did not permit the automatic lien-stripping accepted by the court of appeals.

D. The Frazier-Lemke Act Did Limit the Value of a Creditor's Lien, but This Court Held It Unconstitutional.

To be sure, one pre-Code enactment did purport to limit the ability of secured creditors to retain their liens through a bankruptcy proceeding. Enacted in an effort to stem the flood of farm foreclosures related to the Great Depression, the Frazier-Lemke Act, ch. 869, 48 Stat. 1289 (1934), sharply limited the remedies available to mortgage lenders. Among other things, the statute allowed a borrower to retain a farm, free of a lien, if the farmer tendered into the court the value of the property as appraised. *Id.* at 1290 (codified at 11 U.S.C. 5(s)(7) (1936)). That provision had only limited effect, however, because this Court – emphasizing how far Frazier-Lemke went beyond the

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[23] *See Northern Pacific Railway v. Boyd*, 228 U.S. 482, 502-10 (1913); *Kansas City Terminal Railway v. Central Union Trust*, 271 U.S. 445, 453-56 (1926); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 114-32 (1939); Douglas Baird & Robert Rasmussen, *Boyd's Legacy and Bankruptcy's Ghost*, 1999 Sup. Ct. Rev. 393, 397-408.

bounds of traditional bankruptcy rules – held the statute invalid as a taking of the property interests that lenders held in their collateral. *Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 589-602.

The centrality of the lender's right to retain the entire value of its lien was underscored by the Court's treatment a few years later of the revised Frazier-Lemke Act, ch. 792, 49 Stat. 942 (1935). In concluding that the revised statute was constitutional, the Court emphasized that the revised statute preserved "[t]he right to retain the lien until the indebtedness thereby secured is paid." *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 457 (1937). Indeed, the opinion of Justice Brandeis went out of its way to emphasize that pre-enactment "[a]mendments to the bill subsequent to its introduction plainly demonstrate careful intention to leave the lien wholly unimpaired." *Id.* at 458 n.2. As Justice Brandeis explained, the original bill would have obligated the lender to accept the appraised value of the collateral (the same course of action that respondents advocate); the statute was revised before adoption because of concerns that such an intrusion on the rights of secured lenders would amount to an unconstitutional taking of property. *Id.* Only with that amendment did the statute pass this Court's constitutional scrutiny.

One thread runs through all those decisions and the statutes that they construe: the principle that liens pass through bankruptcy unaffected – except in the carefully cabined circumstances of modern-day reorganization proceedings – has deep roots in the common law, the bankruptcy statutes, and the Constitution. It applies to all liens, regardless of their priority, regardless of the value of the collateral that secures them.

CONCLUSION

Rejection of *Dewsnup*'s application to inferior liens would fly in the face of historical practice and destabilize a crucial sector of our all-too-fragile lending markets. We respectfully submit that the Court should reverse the decisions of the court of appeals.

Respectfully submitted,

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BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

and

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF *AMICI CURIAE* THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AND AARP IN SUPPORT OF THE RESPONDENTS

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INTEREST OF *AMICI CURIAE*[1]

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization with a membership of more than 3,000 consumer bankruptcy attorneys nationwide. NACBA's mission includes educating the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various courts on behalf of consumer bankruptcy debtors. *See, e.g.*, *Lamie v. U.S. Trustee*, 124 S.Ct. 1023 (2004) (discussing § 330); *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010); *United Student Aid Funds Inc. v. Espinosa*, 130 S. Ct. 1367 (2010); *Mort-Ranta v. Gorman*, 721 F.3d 241 (4th Cir. 2013); *Weber v. SEFCU*, 719 F.3d 72 (2d Cir. 2013).

AARP is a non-profit, nonpartisan organization, with a membership that helps people turn their goals and dreams into real possibilities, seeks to strengthen

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represent they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus*, its members, or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Petitioner Bank of America, N.A. has consented to the filing of *amici curiae* briefs and a letter reflecting its consent was filed contemporaneously with this brief. Respondents David Caulkett and Edelmiro Toledo-Cardona have filed a blanket consent to the filing of any amicus brief, which was docketed on November 18, 2014.

communities, and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse. AARP has advocated in this Court on behalf of homeowners and others who seek a fresh start under the Bankruptcy Code. *Till v. SCS Credit Corp.*, No. 02-1016; *Rousey v. Jacoway*, No. 03-1407.

In recent years, older Americans have been forced into bankruptcy in increasing numbers as a result of lost jobs, depleted retirement savings, and escalating medical bills. Prior to the recent financial crisis, many put their homes on the line to secure mortgages that were unsustainable and, in some cases, designed to fail. Because of the decline in property values, the debt on their homes far exceeds the value of the property.

Because of their age, it is far more difficult for older people to bounce back from enormous financial setbacks such as these. For many, the ability to avoid a second mortgage that is unsupported by any equity is the difference between keeping their homes and losing them.

STATEMENT

The question in this case is whether § 506 of the U.S. Bankruptcy Code,[2]—which provides that a lien in excess of the value of the collateral is "void"—permits a Chapter 7 debtor to extinguish or "avoid" a mortgage lien on his personal residence where the collateral to which the lien attaches, is found to have no value. Permitting debtors to avoid such valueless liens is consistent with the plain language of the Code, with basic constitutional principles that underlie treatment

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[2] 11 U.S.C. § 101 *et. seq.* (the "Code").

of secured creditors under modern bankruptcy law, and with sound economic and foreclosure policy.

Section 506 embodies the fundamental principle that runs throughout the entire Code that a creditor's claim is treated as a "secured claim" only to the extent that there is actual value to support it and that the excess is "void." As § 506(a) provides, an allowed claim is a secured claim "to the extent" of the value of the collateral. The balance of the claim is a separate unsecured claim, a point that is noted again in § 506(d), which provides that the lien is void to the extent that the claim is not an allowed secured claim.

The power of Congress to enact statutory provisions that avoid liens of secured lenders is grounded on well-established constitutional principles. This Court held over 70 years ago that secured creditors are entitled to protection of their lien "throughout the proceedings, to the extent of the value of the property [and that] [t]here is no constitutional claim of the creditor to more than that."[3] This fundamental principle was stated in *United States v. Ron Pair Enter., Inc.* 489 U.S. 235, 239 (1989), which held that "a claim is secured only to the extent of the value of the property on which the lien is fixed."

The reduction of secured liens to the value of the collateral is central to modern bankruptcy practice and in particular to the reorganization chapters, namely, Chapters 11, 12 and 13. This principle enables the bankruptcy courts to adjust the debts of large commercial debtors, as well as the small claims on the personal assets of Chapter 7 debtors. Thus, bankruptcy courts routinely bifurcate a secured claim

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[3] *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 278 (1940)(citations omitted).

into a secured component, based on collateral value, and an unsecured component for the balance; the lien on the unsecured portion is then extinguished or voided. This statutory and constitutional authority to modify, extinguish or avoid secured debts, even without full payment of the face amount of the debt, is in harmony with the economic reality that a lien is only as valuable as the collateral that underlies it. Bankruptcy financial restructurings could not occur without such an indispensable legal tool.

In *Dewsnup v. Timm*, 502 U.S. 410 (1992) this Court held that in a Chapter 7 liquidation, where the lender was only partially secured, a debtor could not reduce (or void) the mortgage to the value of the collateral, stating that the "voiding of a lien [occurs only] when a claim secured by the lien itself has not been allowed." 502 U.S. at 416. That is, unless the *claim* itself was disallowed, the lien could not be voided. This Court had never previously indicated such an interpretation.

Justice Scalia dissented, joined by Justice Souter, who correctly pointed out that, under § 506(a) and (d) a valueless lien is void: "Read naturally and in accordance with the other provisions in the statute, this [language] automatically voids a lien to the extent the claim it secures is not both an 'allowed claim' and a 'secured claim' under the Code." *Dewsnup*, 502 U.S. at 420.

Even the majority in *Dewsnup* recognized a crucial limitation on the reach of *Dewsnup*, when it held that lien avoidance is valid in the "reorganization chapters," Chapters 11, 12 and 13. The Court also cautioned that Dewsnup might not apply in other contexts *or to other Code sections*. And just one year later, in *Nobelman v. American Sav. Bank*, 508 U.S.

324 (1993), the Court declined to apply the reasoning of *Dewsnup* to § 506 in a Chapter 13 case.

Bank of America has acknowledged throughout that lien avoidance is permitted in the reorganization chapters. Nevertheless, it has asserted novel interpretations of § 506 which, if accepted and then applied to the reorganization chapters would severely impair the ability of business and individual debtors to use the statutory power to restructure and avoid liens in the reorganization chapters. Because the arguments of Bank of America risk intrusion into the reorganization chapters, NACBA and AARP have submitted this Brief to urge that this Court resist such arguments. Further, NACBA and AARP contend that *Dewsnup* simply does not apply where the lender is entirely unsecured, as here. Alternatively, NACBA and AARP urge reconsideration and reversal of *Dewsnup*.

SUMMARY OF ARGUMENT

Lien avoidance is central to the overall operation of the Bankruptcy Code in all chapters, but in particular in the reorganization chapters. The reduction of liens to the value of collateral occurs in the contexts of plans, sales, exemptions, and many of the most critical aspects of bankruptcy. In *Dewsnup* this Court acknowledged that its ruling did *not apply* in the reorganization context. Bank of America acknowledges that lien avoidance is permitted in the reorganization chapters, but nevertheless both directly and indirectly, tries to limit the scope of lien avoidance in ways that would subvert the historically accepted operation of the reorganization chapters. Bank of America's argument that lien avoidance is permitted only in "narrowly cabined exceptions, principally in the reorganization cases" (Pet. Br. 31-32) inverts what is the exception and what is the rule. Lien avoidance

may not be fairly characterized as any form of exception, but instead is the rule.

Second, this Court in *Dewsnup* expressly stated that it "might be inclined" to agree with the contrary position of the petitioner that a claim is secured only to the extent of the judicially determined value of the real property. 502 U.S. at 417. This position is the rule set forth in *Ron Pair*, stating that § 506 "governs the definition and treatment of secured claims." 489 U.S. at 238-239. That is, a plain language interpretation of §§ 506(a) and (d) expressly supports the avoidance of wholly unsecured liens in Chapter 7.

Bank of America has put forth other arguments to support *Dewsnup* that find no expression or basis in the decision itself. The cornerstone of its argument is that there is a difference between a claim and a lien, from which it then argues that a debtor may modify a claim, but that the associated lien remains intact, and unaffected. This interpretation is at odds with the ability to avoid, to modify and to restructure secured loans in the reorganization chapters and if adopted, would represent a major rejection of established bankruptcy law.

Lastly, Bank of America argues that *Dewsnup* should be extended because, (a) secured lenders have a "property right" that is entitled to be protected from lien avoidance and (b) secured lenders have a bankruptcy right to the future appreciation of their collateral. (Pet. Br. 22, 31-32.) These arguments are inconsistent with accepted bankruptcy theory and practice, including this Court's pronouncements on the actual scope of a secured lender's entitlements under the Fifth Amendment.

This Court should affirm the decision of the Eleventh Circuit. Doing so will be consistent with a plain reading of § 506. Alternatively, if the Court does reverse the Eleventh Circuit, then it should clarify that its ruling has no applicability to Chapters 11, 12 or 13 of the Code.

ARGUMENT

I. *DEWSNUP* SHOULD NOT BE EXTENDED: THIS COURT CORRECTLY DECLINED TO EXTEND THE RATIONALE OF *DEWSNUP*.

One of the central tenets of modern bankruptcy law concerning secured lenders is that the "allowed secured claim" is measured by the value of the collateral that secures the claim. *See, e.g., United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371-372 (1988). ("The phrase "value of such creditor's interest" in § 506(a) means "the value of the collateral.") *Ron Pair* held the same. 489 U.S. at 238 n.2. *See also, Associates Commercial Corporation v. Rash,* 520 U.S. 953, 957 (1997)("The value of the allowed secured claim is governed by § 506(a) of the Code.").

Despite these prior rulings, Bank of America argues that in *Dewsnup,* "this Court soundly rejected" the reading of § 506 which holds that a claim is only a secured claim "to the extent" that a lien has value. (Pet. Br. 13.) There was however, no such "sound" rejection. The majority of this Court strongly indicated that *Dewsnup* is to be strictly limited. Other members of this Court have expressed grave reservations about

the ruling in *Dewsnup*.[4] Indeed, if anything, reconsideration of *Dewsnup* is warranted.

A. This Court expressly limited *Dewsnup* and declined to extend the ruling to the reorganization provisions of Chapters 11, 12 and 13.

Bank of America argues that § 506 only voids a lien where the underlying claim itself is not enforceable. (Pet. Br. 3.) In its view, the value of the collateral has no role. As noted, it claims that this Court soundly rejected the plain meaning interpretation of § 506, which forms the basis for, and is more consistent with, *Ron Pair*.

In truth, this Court expressed serious and meaningful reservations about *Dewsnup* in that decision itself, and certainly about any broader application. Significantly, this Court stated that "were we writing on a clean slate" we "might be inclined" to adopt the contrary rule urged by petitioner. 502 U.S. 417. The contrary rule is the view expressed in *Ron Pair* that § 506 has a plain meaning, and that an allowed secured claim is measured and defined by the value of the collateral.[5]

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[4] Justice Thomas implored the Court not to repeat the "methodological error committed by this Court in Dewsnup." *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 461 (1999). (Thomas, J., concurring in the judgment).

[5] As Justice Scalia noted in *Dewsnup*, "Almost point for point, today's opinion is the methodological antithesis of *Ron Pair*—and I have the greatest sympathy for the Courts of Appeals who must predict which manner of statutory construction we shall use for the next Bankruptcy Code case." 502 U.S. at 435.

This Court's decision in *Ron Pair* presents the correct starting point for understanding the historical development and meaning of § 506, much of which is at odds with the views argued by Bank of America. The question presented in *Ron Pair* was whether an oversecured lender was entitled to post petition interest. 489 U.S. at 237. This Court acknowledged that "Section 506, enacted as part of the extensive 1978 revision of the bankruptcy laws, governs the *definition and treatment* of secured claims, *i.e.*, claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." *Id.* at 238-239 (emphasis added). And, importantly, this Court stated that "Subsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of the lien is considered unsecured." *Id.* at 239.[6]

While Bank of America argues that Congress gave no sense that it intended for § 506 to effectuate any changes in pre-Code law, (Pet. Br. 13), this Court said the opposite in *Ron Pair*. The *Ron Pair* decision essentially found that § 506 *was* part of a major revision to pre-Code law, was not ambiguous and thus, reliance on pre-Code law was not appropriate:

> Initially, it is worth recalling that Congress worked on the formulation of the Code for a

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[6] This Court provided a key example: "Thus, a $100,000 claim secured by a lien on property of a value of $60,000, is considered to be a secured claim to the extent of $60,000, and to be an unsecured claim for $40,000. See 3 Collier on Bankruptcy, ¶ 506.04, p. 506-15 (15th ed. 1988). ("[S]ection 506(a) requires a bifurcation of a 'partially secured' or 'undersecured' claim into separate and independent secured claim and unsecured claim components."). 489 U.S. at 239 n.3.

> decade. It was intended to modernize the bankruptcy laws. and as a result made significant changes in both the substantive and procedural laws of bankruptcy. In particular, Congress intended 'significant changes from current law in. the treatment of secured creditors and secured claims. . . . In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. (citations omitted). [7]

Further, and critically, this Court in *Dewsnup* noted that its views on lien avoidance were "apart from [the] reorganization proceedings," where lien avoidance is permitted. 502 U.S. at 418. This Court specifically declined to predict that its ruling would apply to other "fact situations" nor that it would it be applied in the same way to other Code provisions. *Id.* at 416. "[W]e express no opinion as to whether the words 'allowed secured claim' have different meaning in other provisions of the Bankruptcy Code." *Id.* at 417 n.3.

This Court's reservations were well grounded. The extension of *Dewsnup* based on Bank of America's arguments is unwarranted and only risks further confusion. Instead this Court should limit *Dewsnup* and harmonize its interpretation with *Ron Pair* and *Nobelman*, so as to recognize the centrality of lien avoidance, especially in the reorganization chapters.

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[7] *Ron Pair*, 489 U.S. at 240.

B. The extension of *Dewsnup* should not be permitted based on the argument that a lien and a claim are separate and distinct.

Because Bank of America must recognize that this Court has shown a firm disinclination to extend the reasoning of *Dewsnup*, Bank of America has offered a rationale that is not found in the text of the decision. Bank of America argues that there is a distinction for bankruptcy purposes between a creditor's claim and its lien, and that this is a key feature of the architecture of the Code and is "critical to this case." (Pet. Br. 6.) It argues that this distinction exists "[b]oth outside and inside bankruptcy." (Pet. Br. 5.)

This alleged distinction between the permitted Code treatment of a lien and a claim is a wholly novel and incorrect interpretation that would undercut the fundamental workings of the reorganization chapters. It would do so by severely limiting the right of debtors to restructure and void undersecured liens. In a word, Bank of America argues that the authority given to debtors to modify debt (e.g., to "treat" the debt) somehow speaks only to the "claim" but not to the lien: "Put differently, the value of the collateral securing a debt affects only the *treatment* of the creditor's claim against the chapter 7 estate. It does not affect the validity of the creditor's lien." (Pet. Br. 13.) (emphasis altered).

Bank of America's self-defined "critical argument" represents an unprecedented change in the historical treatment of secured lenders under the Code. It seems to ignore this Court's long standing holding that a secured lender is entitled to protection of its lien only "to the extent of the value of the property" to which the lien attaches. *Wright*, 311 U.S. at 278. That is, *all*

of the "rights" of a secured lender as such (whether those rights are said to spring from the claim or the associated lien) are *only* protected to the extent of the value of the collateral. If Bank of America's argument were to become law, then the ability to modify liens could be lost, despite plain statutory and judicial authority to the contrary. In other words, despite acknowledging that this Court stated specifically that *Dewsnup* does *not apply* to the reorganization chapters, Bank of America makes an argument that could be readily transported, in a future case, to the reorganization chapters. This Court should reject this unprecedented distinction between the power to modify and the power to modify a secured claim.

First, a lien and a claim, for bankruptcy law purposes, are largely co-extensive for purposes of understanding the Code's treatment of such. Bank of America's argument that a lien and claim are different was contradicted by this Court just one year prior to *Dewsnup*, in *Johnson v. Home State Bank*, 501 U.S. 78 (1991) which held the opposite. Instead, this Court stated "we have no trouble concluding that a mortgage interest that survives the discharge of a debtor's personal liability is a 'claim' within the terms of § 101(5)." 501 U.S at 84. This is because, in part, there remained a right to payment in the form of proceeds from the sale of the debtor's property. Further, the Court in *Johnson* said that "but for the codification of the rule of *Long v. Bullard*, there can be little question that a 'discharge' under Chapter 7 would have the effect of extinguishing the *in rem* component as well as the *in personam* component of any claim against the debtor. And because only claims are discharged under the Code, the very need to codify *Long v. Bullard* presupposes that a mortgage interest is otherwise a claim." 501 U.S. at 84 (citation omitted). In short, it

said "a surviving mortgage interest is a 'claim' under § 101(5). " *Id.* at 85.

Second, as a statutory matter, the statement that the Code treats a claim and a lien as distinct is not accurate. Section 102(2) states plainly that a "claim against the debtor" includes a claim against property of the debtor. A lien is a claim against property of the debtor.

Third, the notion that an allowed secured claim and a lien are largely co-extensive is consistent with this Court's ruling in *Ron Pair*. While Bank of America argues that the value of the collateral only affects the treatment of the claim and not the lien, this Court said that the value of the collateral determines the extent of the secured claim. "[A] claim is secured only to the extent of the value of the property on which the lien is fixed." *Ron Pair* 489 U.S. at 239. In this formulation, claim and lien are linked by value. They are inseparable. *Nobelman* said the same thing, as did *Rash*. This effort by Bank of America to separate the claim from the lien, and to inhibit the power to modify the claim only would effectively reverse an entire body of this Court's case law.

The lien-claim distinction finds no basis in *Dewsnup* and provides no basis to revive or extend *Dewsnup*. It is entirely at odds with the basic workings of the Code and should be soundly rejected by this Court. It's potential harm to the reorganization cases (discussed below) is far too significant to permit any embrace of such a notion. Just as the "plain meaning" of § 506 will not support extension of *Dewsnup*, neither will this "critical" argument by Bank of America.

II. LIEN AVOIDANCE IS CENTRAL TO MODERN BANKRUPTCY ADMINISTRATION AND PRACTICE IN ALL OF THE REORGANIZATION CHAPTERS.

Bank of America acknowledges that lien avoidance is permitted in the reorganization chapters, including Chapter 11 (Pet. Br. 20, 22-23, 31-32, 38, 39 n. 20)[8] and that it was permitted under pre-Code practice. (Pet. Br. 13.)[9] Indeed, it relies heavily on the express power to modify secured claims in the reorganization chapters as further support for its argument that § 506(d) is not sufficient by itself to do the same.

Yet, despite this acknowledgement, it argues that *Dewsnup* should be extended in this case because lien avoidance is an exception to the basic operation of the Code, and that the survival of liens is the basic statutory outcome of bankruptcy law. Bank of America argues that the Code shows no clear intention to deny lienholders of their basic state-law property rights, and that the Code is carefully designed to preserve those rights, with certain "narrowly cabined exceptions, principally in the reorganization cases." (Pet. Br. 31-32.) Later, it argues that lien avoidance is permitted "only in specific and limited circumstances." (Pet. Br. 35.)

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[8] Amicus curiae, the Loan Syndication and Trading Association, ("LSTA") acknowledges the same. (LSTA Br. 20, 21.)

[9] "Apart from reorganization proceedings, no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." citing *Dewsnup*, 502 U.S. at 418-419. The LSTA acknowledges that the Chandler Act permitted modification of a secured creditor's lien but only in a "plan." (LSTA Br. 20.)

This portrayal inverts the true relationship between what is central in bankruptcy and what is a narrow exception. The modern 1978 Code uses lien modification and avoidance as one of the fundamental tools to enable reorganization as well as the fresh start for Chapter 7 debtors. As stated by this Court, the protection of secured lenders in bankruptcy is "to the extent of the value of the property" and that "there is no constitutional claim of the creditor to more than that."[10] Unless Congress specifically states that a lien cannot be modified, the normal operation of the Code permits modification of secured debt, including lien avoidance. This is hardly a narrow cabin. The arguments advanced by Bank of America would work an historic shift in bankruptcy jurisprudence and should be rejected.

A. Lien avoidance is central to the operation of Chapter 11.

Courts generally agree that *Dewsnup* does not apply in the reorganization chapters. "A great majority of the courts that have considered the issue in reorganization cases have concluded that the holding in *Dewsnup* should be limited to Chapter 7 cases and should not prevent lien avoidance in reorganization cases."[11] Given the critical role of Chapters 11, 12 and 13 in restructuring debt, it could hardly be otherwise. Lien modification and reduction is central to Chapter 11 and indeed goes to the very core of how modern bankruptcy works.

The Third Circuit recently stated that *Dewsnup* cannot apply in Chapter 11 without injuring its

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[10] *See Wright v. Union, supra.*, 311 U.S. at 278.

[11] *In re Johnson*, 386 B.R. 171, 175 (Bankr. W.D. Pa. 2008) *aff'd sub nom. I.R.S. v. Johnson* 415 B.R. 159 (W.D. Pa. 2009).

central functions. "[T]he process of lien stripping is ingrained in the reorganization provisions of the Bankruptcy Code. .[A]ny attempt to extend the holding in *Dewsnup* to Chapter 11 cases would require that numerous provisions of the statute be ignored or construed in a very convoluted manner." *In re Heritage Highgate, Inc.*, 679 F.3d 132, 144 (3d Cir. 2012).

The basic power to modify liens in Chapter 11 is set forth in § 1123(b)(5), which empowers a court to approve a plan that permanently modifies "the rights" of a secured lender:

> (b) Subject to subsection (a) of this section, a plan may—
>
> * * * *
>
> (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence

This power to "modify the rights" speaks directly to the power to modify all rights, regardless of whether they spring from the note or claim, or the mortgage instrument. There is no claim-lien distinction on the power to modify. "Rights" means all rights, including those that are lien based. Thus, while § 506 provides for lien avoidance, § 1123 gives courts the additional power to modify even rights springing from state law. Indeed, this was the very conclusion reached by this Court in *Nobelman*, decided just one year after *Dewsnup* (see discussion below).

Further, the effect of confirmation is to extinguish all claims and *interests* that existed pre-petition and to provide instead, that the claim holders shall have only what they receive under a confirmed plan. Thus

§ 1141(c) states expressly that the property dealt with in a plan (including a lender's collateral) is "free and clear of all claims and interests."

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor. and any creditor.
>
> * * * *
>
> (c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors.

At the very core of how modern Chapter 11 works is the notion of "cram down" found in § 1129(b)(2) which permits a business debtor to reduce a secured claim to the judicially determined value of the collateral. Here the Code is explicit that the lien is retained *only* to the extent of the value of the collateral. This section states:

> (A) With respect to a class of secured claims, the plan provides—
>
> (i)(I) that the holders of such claims retain the liens securing such claims to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the

> effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

An instructive example of how lien avoidance operates in the normal Chapter 11 case was set forth by this Court in the landmark decision of *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship* 526 U.S. 434 (1999). In *203 North LaSalle* the owners proposed a plan of reorganization that bifurcated a $93 million mortgage loan into secured and unsecured portions, based on the judicial valuation. *Id.* at 438-439. Under the plan, the debtor proposed to provide Bank of America with a secured claim of $54.5 million based on § 506(a) and the value of the collateral. *Id.* at 440. Then, as to the unsecured portion, the debtor proposed a permanent lien avoidance by paying only 16% of the allowed unsecured claim. *Id.* The pre petition lien of $38.5 was to be voided. *Id.*

No mention is made in the *203 North LaSalle* decision of an argument about a lien-claim distinction. This Court analyzed the case on the basis that lien avoidance was permitted and occurred as part of the normal operation § 506. The reported decision shows that neither this Court nor Bank of America remotely questioned the power of the lower court to bifurcate the lien and to extinguish the unsecured portion of the lien.

Nor does the *203 North LaSalle* reflect that any argument was made that lien avoidance violates the notion that a lender must always be paid in full as a condition to release of its lien. The notion put forth by both Bank of America and its amicus, that a lender is entitled to retain its lien unless and until paid in full is without any basis, if asserted as some kind of

overarching bankruptcy principle. The very opposite is more accurate. This Court criticized the Solicitor's General's office for its "starchy" view that owners cannot retain any interest "if creditors are not paid in full." *See id.* at 451-452. Bank of America essentially makes the same "starchy" argument in this case.

Lien avoidance is thus at the core of Chapter 11. One court stated that to bar lien avoidance would "gut the sum and substance of the reorganization and rehabilitation of debt concept" in its entirety:

> [Without lien avoidance] the Debtor would propose a plan for repayment of creditors to the extent of the value of the property securing the creditor's claim, but would still owe the unsecured portion of the claim, post-confirmation, in order to obtain a release of the lien on said property. This would require all plans filed under Chapters 11, 12 and 13 to pay all creditors one hundred percent of their claims in order for the debtor to emerge from bankruptcy with a true "fresh start." Clearly, this has never been the purpose contemplated for Section 506 (d).

In re Johnson, 386 B.R. at 177 quoting *In re Butler*, 139 B.R. 258, 259 (Bankr. E.D. Okl. 1992).

Bank of America has put forth an argument that it did not make when a form of lien avoidance was last before this Court in a Chapter 11 case. It should not now be the basis for extending *Dewsnup* to wholly unsecured loans and especially not to the reorganization chapters.

B Section 506 complements the avoidance powers found in Chapter 11.

Bank of America argues that if § 506(d) itself permitted lien avoidance then the reorganization sections, discussed above, would be superfluous. (Pet. Br. 32, 39.) Yet, the very opposite is true. Section 1129(b)(2) works in tandem with § 506's avoidance power. As the first step, § 506 provides that the secured creditor will retain its lien "to the extent of the allowed amount of such claims," and then receive under the plan (almost always in the form of a new note or debt instrument) a new loan obligation that has a face amount at least equal to the value of the collateral on the effective date of the plan. § 1129(b)(2)(A)(i). Because the payments will be made over time, the present value of the payments must also be equal to the value of the collateral.

In the second step, § 506(d) complements this process by voiding the remainder of the lien. Then, § 1129(b)(2)(B) provides for the "treatment" of the resulting deficiency claim which is now classified as an unsecured claim and is equal to the excess over the value of the collateral. Section 506 is thus not superfluous, because once the lien avoidance occurs, the Code must still provide for the correct "treatment" of the bifurcated claims.

C. Lien avoidance is central to the operation of Chapter 13.

It is undisputed that Congress has expressly provided for lien avoidance in Chapter 13 as a general matter; Bank of America acknowledges this. ("[C]hapter 13 permits a plan to strip down an undersecured creditor's lien to the value of the collateral in certain circumstances.")(Pet. Br. 38.)

Judge Gorsuch, writing for the Tenth Circuit noted that "every federal court of appeals to consider the question has already refused to extend *Dewsnup's* definition of the term 'secured claim' to other statutory provisions using that term in Chapter 13 " *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1276 (10th Cir. 2012).[12] *See also In re Enewally*, 368 F.3d 1165, 1170 (9th Cir. 2004), where the court stated:

> The rationales advanced in the *Dewsnup* opinion for prohibiting lien stripping in Chapter 7 bankruptcies, however, have little relevance in the context of rehabilitative bankruptcy proceedings under Chapters 11, 12, and 13 where lien stripping is expressly and broadly permitted, subject only to very minor qualifications. The legislative history of the Code makes clear that lien stripping is permitted in the reorganization chapters.

This Court has consistently held that lien avoidance is permitted in Chapter 13, and that the lien is avoided based on the value of the collateral. In *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), this Court stated as follows:

> At the time of the filing, respondent's outstanding claim amounted to $4,894.89,

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[12] "This same pattern—of circuits distancing themselves from *De nup*—recurs in Chapter 11 and Chapter 12 reorganization ases. Most notably, the Supreme Court itself has declined to extend *Dewsnup*'s understanding of the term "secured claims" when it appears in Chapter 13 . So it is that *Dewsnup* has lost every away game it has played: its definition of "secured claim" has been rejected time after time elsewhere in the code and seems to hold sway only in § 506(d)." *Id.* at 1276.

> but the parties agreed that the truck securing the claim was worth only $4,000. App. 16-17. In accordance with the Bankruptcy Code, therefore, respondent's secured claim was limited to $4,000, and the $894.89 balance was unsecured.

Id. at 470. [13]

The statutory power to avoid liens in Chapter 13 is found in part in § 1322(b)(2) which expressly empowers a court to approve a plan that modifies the rights of a secured creditor, with one limited exception. This section states as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may—
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence .

The permitted "modification" includes a permanent reduction in the loan. Thus, a plan of reorganization in Chapter 13 may do what a plan may do in Chapter 11, namely, "modify" and hence restructure, a debt secured by a lien.[14] If a Chapter 13 debtor owns a car or a boat, then the lien of the secured lender is subject

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[13] *See also, Associates Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997): "In such a 'cram down' case we hold, the value of the property (*and thus the amount of the secured claim* under § 506(a) is the price a willing buyer . . . would pay to obtain like property from a willing seller." (Emphasis added.)

[14] "Thus, in cases like this involving secured interests in personal property, the court's authority to modify the number, timing, or amount of the installment payments from those set forth in the debtor's original contract is perfectly clear." *Till*, 541 U.S. 465, 475.

to various forms of modification including loan *and* lien reduction. This reduction is permanent and constitutes lien avoidance.

The effect of confirmation in Chapter 13 is also to effectuate the permanent avoidance of any lien or claim dealt with in the plan. Liens do not remain in place after confirmation, except as provided in a plan. Thus § 1327(c) states as follows:

> (c) Except as otherwise provided in the plan or the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

An example of how lien avoidance operates in Chapter 13 is found in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993). In *Nobelman*, the question presented was whether a debtor could avoid a partially unsecured mortgage lien. *See id.* at 325-326. The Nobelmans had purchased a home with a loan from American Savings Bank for $68,250. At the time of their proposed Chapter 13 plan, the uncontroverted valuation of the home was $23,500. Petitioners sought to make payments based on this value, and to avoid the remaining balance in excess of the $23,500. *Id.* at 326.

Nobelman also illustrates the proper relationship between § 506 and the specific provisions that permit treatment of claims after the bifurcation occurs in § 506. The Court stated that after conducting a valuation under § 506(a), a partially secured claim will be bifurcated into its secured and unsecured portion,

with that portion having no value being treated as an unsecured claim:

> Petitioners were correct in looking to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. It was permissible for petitioners to seek a valuation in proposing their Chapter 13 plan, since § 506(a) states that '[s]uch value shall be determined .in conjunction with any hearing on a plan affecting such creditor's interest."

Id. at 328-329.[15]

Nobelman also acknowledged that valuation of collateral is central to the determination of which portions of a lender's claim are secured, and which are unsecured; the opposite of what Bank of America argues here: "The portion of the bank's claim that exceeds $23,500 [the judicial valuation of the home] is an 'unsecured claim componen[t]' under § 506(a)," citing *Ron Pair* 489 U.S. 235, 239, n. 3.

This Court made no distinction between a lien and a claim. Further, implicit in the *Nobelman* decision is the corollary principle that if the lien has no economic value based on the underlying collateral, it is totally unsecured, and is not a secured claim for purposes of the Code.

The *only reason* this Court declined to permit the lien avoidance in *Nobelman* was because § 1322 states

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[15] Justice Scalia, in his dissent in *Dewsnup* observed that "in light of § 506(a)," the prohibition on the power to modify a mortgagee's rights exists "only with respect to the portion of his claim that is deemed secured under the Code." 502 U.S. at 429. (citations omitted).

that a plan cannot "modify the rights" of a creditor secured only by a security interest in real property that is a debtor's principal residence. The dispositive term was "rights." Because of this language the Court looked to state law only, and did not adopt the *Dewsnup* definition of allowed secured claim. *Id.* at 329. Because mortgage lenders have a state law right, *outside of bankruptcy law*, to retain a lien until foreclosure, the Court held that such right could not be modified.

Significantly, this ruling means that the statutory power to modify the "rights" of secured lenders embraces *all rights under state law* and thus makes no distinction between lien and claim. In a word, *Nobelman* directly contradicts the lien-claim argument of Bank of America, which it describes as its critical argument.

III. SECURED LENDERS DO NOT HAVE AN ENTITLEMENT TO FUTURE APPRECIATION OF THE COLLATERAL NOR A PROTECTED PROPERTY RIGHT THAT PREVENTS LIEN AVOIDANCE.

A. Lien avoidance does not deprive lenders' of any so-called entitlement to future appreciation.

Bank of America argues that lien avoidance should be prohibited in Chapter 7, because secured lenders are entitled to the future appreciation of their collateral. (Pet. Br. 4, 22.) It argues that its "bargain" included the possibility of future appreciation at the time of foreclosure. (Pet. Br. 26.) Bank of America acknowledges, however, as a factual matter, that the right to foreclose *now* would be of no value. "[I]f the house were sold today, Bank of America would obtain

no recovery." (Pet. Br. 26.) The record contains no evidence on likely future appreciation.

These assertions are incorrect and run contrary to well-established principles of bankruptcy law. First, as to any supposed "bargain" (which is also absent from the record) bankruptcy law is premised on the constitutional notion that state contract rights (the "bargain") may in fact be modified and even abrogated. This power resides in the Bankruptcy Clause (U.S. CONST. art. I, § 8, cl. 4). "The Bankruptcy Clause necessarily authorizes Congress to make laws that would impair contracts. It long has been understood that bankruptcy law entails impairment of contracts." *In re City of Detroit, Mich.*, 504 B.R. 97, 137-38 (Bankr. E.D. Mich. 2013) (internal citations omitted)"[16]

Nor does the Fifth Amendment create a right to future appreciation. The controlling principle is that a secured lender's "rights" are the preservation of the value of its lien "throughout the proceedings."[17] There is no constitutional right to any value accrual after the bankruptcy proceedings are complete.

Justice Scalia recognized in *Dewsnup* that there is no entitlement to future appreciation under bankruptcy law. "There, no more than under Chapter 7, can [secured lenders] demand the benefit of

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[16] Judge Rhodes cited *Sturges v. Crowninshield*, 17 U.S. 122, 191 (1819). *Id.* at 138. Contractual bargains in loan agreements are often impaired as part of the normal operation of bankruptcy. Section 1123(b) expressly provides that a plan of reorganization may "impair .any class of claims, secured or unsecured " Impairment means to alter the legal, equitable or contractual rights to which a creditor might otherwise be entitled to under state law. *See* § 1124.

[17] *See Wright*, 311 U.S. at 278, discussed at Kenneth N. Klee, BANKRUPTCY AND THE SUPREME COURT, 147 (2008).

postevaluation increases in the value of property given as security." 502 U.S. at 430.

The circuit courts have also recognized this principle. As the Third Circuit correctly stated, "a secured lender's expectation of benefiting from the eventual appreciation of collateral (the so-called "upside" of the collateral) is not an entitlement when the property is part of a bankruptcy estate." *In re Philadelphia Newspapers, LLC.*, 599 F.3d 298, 316 (3d Cir. 2010).[18] The Third Circuit added that "asserting an absolute right to [the upside in collateral] is plainly contrary to other provisions of the Code . ." *Id.*

> The Bankruptcy Code. does not protect a secured creditor's upside potential; it protects the "allowed secured claim." If a creditor were over-secured, it could not demand to keep its collateral rather than be paid in full simply to protect the "upside potential."
>
> *Id.* (citing *In re Pacific Lumber*, 584 F.3d 229, 247 (5th Cir. 2009)).

The notion that a lender has a statutory entitlement to future appreciation of its collateral is belied by the provisions dealing with "adequate protection" under § 361. The Code provides that a secured lender is entitled to have its collateral protected against only a "decrease" in value during the course of the case. *See* §§ 361(1) and (2). The courts have uniformly held that absent any provable decrease in value, a secured lender is not entitled to any further protection during the course of the case. *United Savings Ass'n v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 370

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[18] *But see, RadLAX Gateway Hotel LLC v. Amalgamated Bank*, 132 S.Ct.2065 (2012)(disagreement on other issues).

(1988) (noting that a creditor's interest "is not adequately protected *if* the security is depreciating during the term of the stay") (emphasis added).

Further, efforts by lenders to obtain adequate protection during the bankruptcy case for any excess in value over the collateral's current value (the "equity cushion") have likewise been rebuffed by the courts. *See, e.g., Orix Credit Alliance, Inc., v. Delta Resources, Inc., (In re Delta Resources, Inc.),* 54 F.3d 722, 728 (11th Cir. 1995).

Nor is a secured lender entitled to future appreciation of the collateral at the end of the bankruptcy case. In a Chapter 11 case, where the debtor retains the asset, the lender is given a new note based on the present value of the income stream. § 1129(b)(2)(A). Thus, a bankruptcy court is only "require[d] to ensure that the property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total 'value' as of the effective date of the plan, that equals or exceeds the value of the creditor's allowed secured claim . . ." *Till,* 541 U.S. at 474. The judicial determination is made "as of the effective date of the plan." *Id.* The principle is that the judicial valuation on the effective date governs and determines the rights of the lender. The risk of future depreciation or the gain from future growth are with the debtor, not the lender. [19]

If a lender seeks to share in the potential appreciation of collateral at some point after the bankruptcy proceedings, the Code provides two avenues for doing so—but certainly contains no

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[19] "The Supreme Court's opinion in *Dewsnup* does not establish a general principle for allocating post-petition appreciation." *In re Marsh,* 929 F. Supp. 2d 852, 856 (N.D. Ill. 2013).

expression of an automatic "entitlement." First, a lender may request that the trustee or debtor sell the property free and clear under § 363(f). The undersecured lender can credit bid, and acquire the property, subject to the rights of any senior lien holder. *See* § 363(k). This is the same right it would have under state law—namely to bid in at a state foreclosure sale, pay off any first lien, and then, and only then, hold the property for any future appreciation. Otherwise, under state law, the undersecured junior lien is extinguished on the sale by the senior. This is the true "bargain" that Bank of America made here—a risk that it would have its lien extinguished at a foreclosure sale, unless it was willing to purchase the property. [20]

While the Code generally does not provide for a secured lender to protect itself against loss of future appreciation, it does do so in one limited case, but then, only by a specific provision. In a Chapter 11 case, a lender may protect itself against loss of future appreciation of its collateral by operation of § 1111(b). Because the normal operation of the Code is that lenders may have their liens extinguished based on the judicial valuation as of the effective date, the 1978 Code included gave lenders an "election" right to retain their liens up to the face amount of the debt,

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[20] Bank of America did not originate the loans in this case, but acquired the loan portfolio of Country Wide. Brief in Opposition to Petition for Writ of Cert, No. 13-1421, *Bank of America v. Caulkett*, p. 5. The sale was reported to have closed on July 1, 2008. *See* "The Deal that Cost Bank of America $50 Billion-and Counting," Charlotte Observer, August 16, 2014, available at www.charlotte.observer.com. In 2008 Bank of America should have anticipated that the mortgages in the Eleventh Circuit would be subject to lien avoidance, which was then the prevailing law in that circuit. None of this was before the courts below.

even if the value of the collateral was determined to be less than the debt. This was accomplished pursuant to § 1111(b), which provides for such an election.[21] A lender who makes the election, however, does not have an unsecured claim, and in a Chapter 11 case, this can be significant as the lender will not have a large, controlling vote among the unsecured creditor class.

However, the election right does not exist where the lien has no value. The election may only be made where the lien is not of "inconsequential value." Professor Klee states, "If the lien securing the claims is worthless or of inconsequential value, then the class is ineligible to make the election." Klee, "All You Ever Wanted to Know," *supra* at 153.

Thus, the normal operation of Chapter 11 is that lenders' claims are subject to judicial valuation, and then to lien avoidance where the value is less than the debt. Absent the purchase of the collateral, or an election under § 1111(b), any future appreciation is not preserved for the lender. As Justice Scalia observed, even if there is some tension with a lender's view of what is "fair," "Congress. expressly chose to create that alleged tension." *Dewsnup,* 502 U.S. at 435.

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[21] *See e.g. Matter of Tampa Bay Associates, Ltd.*, 864 F.2d 47, 50 (5th Cir. 1989) (discussing Congress' reaction to *Great Nat'l Life Ins. Co. v. Pine Gate Associates, Ltd.*, 2 Bankr. Ct. Dec. 1478 (Bankr. N.D. Ga. 1976), which recognized that under § 506 a lender could be compelled to accept a monetary payment equal to the value of the collateral and have its lien avoided.

B. Lien avoidance does not contravene the Takings Clause of the Fifth Amendment.

Bank of America has also argued that liens are property interests with a "constitutional dimension." (Pet. Br. 23.) It cites *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1886). This argument also appears to cut across all of the reorganization chapters.

The precise constitutional dimension however is limited and reliance on *Radford* for extending *Dewsnup* would be seriously misplaced. As one leading commentator stated, "If Radford is not a dead letter, it is of limited vitality. Thus, secured creditors cannot rely on the Takings Clause to limit the modification of their property rights in bankruptcy cases." Klee, BANKRUPTCY AND THE SUPREME COURT, *supra* note 17 at 141-142

Radford has been recognized as having very limited applicability, and certainly as not preventing Congress from adopting § 506 for the purpose of permitting lien avoidance or altering the contractual bargain of a secured lender. "In the final analysis, however, the Due Process Clause, not the Takings Clause, provides secured creditors with the baseline protection of property rights in bankruptcy. Property rights do not gain any absolute inviolability in the bankruptcy court because created and protected by state law." [22]

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[22] *See* Klee, BANKRUPTCY AND THE SUPREME COURT, supra at 141-142 citing *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 518 (1938).

The constitutional framework relates directly to the issue in this case over the meaning of § 506. The Bankruptcy Code "protects the rights of secured creditors, throughout the proceedings, *to the extent of the value of the property*. There is no constitutional claim of the creditor to more than that."[23] The arguments by Bank of America for an extension of *Dewsnup* cannot be based on the Fifth Amendment.

IV. *DEWSNUP* SHOULD BE REVERSED; LIEN AVOIDANCE IS PERMITTED IN CHAPTER 7.

Bank of America argues that Chapter 7 stands alone, and that the interpretation of § 506(d) in *Dewsnup* is correct because "liens pass through bankruptcy unaffected." (Pet. Br. 13.) This argument too fails.

The categorical statement that liens pass through Chapter 7 unaffected is overbroad and inaccurate. While the discharge *itself* does not effectuate a lien avoidance, other provisions do provide for such. "Chapter 7 indubitably permits liens to be removed in many situations." *Woolsey v. Citibank (In re Woolsey)*, 696 F.3d 1266,1274 (10th Cir. 2012). The Eighth Circuit agreed:

> At this point, we think it wise to address the conventional wisdom that liens pass through bankruptcy unaffected. As Judge Posner recently demonstrated in *In re Penrod*, 50 F.3d 459, 461–62 (7th Cir. 1995), this "old saw" is actually far too broad, for there are many ways in which liens may be affected by bankruptcy proceedings. To name just a few,

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[23] *Wright*, supra, 311 U.S. at 278. *See also*, Klee, *id.* at 147.

> a lien may be removed from collateral and replaced by adequate protection if the trustee obtains permission to sell property free and clear of liens, *see* 11 U.S.C. § 363(e)-(f) (1994), or voided if the related claim is disallowed, *see* 11 U.S.C. § 506(d) (1994), or avoided to the extent it impairs an exemption of the debtor, *see* 11 U.S.C. § 522(f) (1994), or avoided if it is the result of a preference or a fraudulent transfer, *see* 11 U.S.C. §§ 547–548 (1994). Because all of these provisions are applicable in Chapter 7, it is not even accurate to say that liens pass through Chapter 7 unaffected.

Harmon v. U.S. Through Farmers Home Admin., 101 F.3d 574, 581 (8th Cir. 1996).

Lien avoidance is central to the proper operation of bankruptcy. While NACBA and AARP have primarily urged that this Court reject any argument by Bank of America that could endanger the historic operation of the reorganization Chapters, they further urge that this Court reconsider *Dewsnup*, give full recognition to the power to avoid liens even in Chapter 7, and affirm the decision of the Eleventh Circuit.

CONCLUSION

For all of the foregoing reasons, NACBA and AARP respectfully request that the decision of the Eleventh Circuit be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF OF *AMICUS CURIAE* NYU LAW SCHOOL BANKRUPTCY APPELLATE CLINIC IN SUPPORT OF RESPONDENTS

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INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is the New York University School of Law Bankruptcy Appellate Clinic. The undersigned Arthur J. Gonzalez, counsel of record for the clinic, is a Senior Fellow at the NYU School of Law, a former judge of the United States Bankruptcy Court for the Southern District of New York, and one of the instructors of the clinic. The undersigned and the participants in the clinic are deeply interested in bankruptcy law, including the issues presented in this case.

The purpose of this brief is to address important matters that bear on the resolution of the issues that arise in this case. These include examination of not only the text of section 506, its context within the Bankruptcy Code, and its

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. All parties have been timely notified of the undersigned's intent to file this brief; both Petitioner and Respondents have consented to the filing of this brief in these consolidated cases. Respondents have filed with the Court a letter consenting to the filing of *amicus curiae* briefs in support of either or neither party. A copy of Petitioner's consent is filed herewith.

relevant history, but also the larger policies of the Code and the Court's interpretative canons long applied in cases of this kind. It is anticipated that, in particular, the discussion of the role that section 506 plays in disencumbering overly leveraged assets in bankruptcy is not one addressed in detail by other participants in this proceeding.

STATEMENT

In 2006, David Caulkett (Caulkett) purchased the home in which he and his wife currently reside for $249,500. Opp. at 5. Caulkett financed the purchase with two mortgage loans, granting a first mortgage lien to secure a "senior" loan in the amount of $199,600, and a second or "junior" mortgage lien to secure a second loan of $49,900. *Id.* Caulkett made payments on both of these loans until May of 2013, when he filed for bankruptcy in the U.S. Bankruptcy Court for the Middle District of Florida. *Id.* at 6.

Caulkett's primary asset is the home. Resp't's Bankr. Pet. at 6. At the time of the commencement of his bankruptcy case in 2013, the value of the property had declined to approximately $98,000, a fraction of its 2006 purchase price. Opp. at 6. The debts secured by the first and second mortgage liens, however, have declined more modestly—the first loan, held by Seterus, Inc., stands at about $183,264 and the

second loan, held by Bank of America, at $47,855. *Id.*

By its terms, a junior mortgage is exactly what the term suggests—second in priority to the first mortgage. *See* Fred E. Case, *The Use of Junior Mortgages in Real Estate Financing*, 10 J. Fin. 41, 42 (1955). This means that if there is not enough value in the home to satisfy the first mortgage in, for example, a foreclosure proceeding, the junior mortgagee is entitled to nothing from the collateral and its lien is deemed, in the vernacular, to be "wholly underwater." In general, institutions that take junior mortgages charge higher interest rates on their loans than those that take first-priority mortgages to compensate for the risk that there might not be sufficient value in the collateral to cover their loans.

Although the holders of junior mortgage liens may find themselves deeply "underwater," this does not mean that they lack leverage against debtors such as Caulkett and competing senior mortgage holders. For example, even though their liens may be ostensibly worthless, junior lienholders may still threaten to place overly encumbered properties into foreclosure, or thwart market-price "short sales" approved by senior lenders, by refusing to consent to the release of their underwater junior liens unless they receive payment of some kind. *See* Prashant Gopal and John Gittelsohn, *Home Sales Held Hos-*

tage by Junior Lien Holders: Mortgages, Bloomberg Business Week (July 23, 2012), http://www.bloomberg.com/news/articles/2012-07-23/home-sales-held-hostage-by-junior-lien-holders-mortgages.[2] In other words, the holders of junior mortgages have certain "hold out" powers, the exercise of which may force properties that might otherwise be sold in successful short-sale transactions into foreclosure, which in turn may encourage home abandonment.[3]

In order to avoid foreclosure and retain his home, Caulkett stated his intention to reaffirm the primary loan held by the first-priority mortgagee. Resp't's Bankr. Pet. at 35. Because the amount of the first mortgage vastly exceeds the value of the home, however, Caulkett is unwilling to assume the first mortgage loan unless he

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[2] The term "short sale" refers to a sale of real property that does not generate sufficient proceeds to pay off in full applicable mortgage loans encumbering the property. *See* 1 Baxter Dunaway, *Law of Distressed Real Estate* § 3B:8 (2008).

[3] *See, e.g.*, Brendan Buschman, *Why Not Strip to Save Your Home? Prohibition on Chapter 7 Strip Off Makes No Cents for Debtors or Creditors*, 22 J.L. & Pol'y 267, 295-96 (2013) (explaining how the preservation of unsecured junior liens incentivizes home abandonment and citing to the parallel discussion from *Folendore v. United States Small Business Administration (In re Folendore)*, 862 F.2d 1537, 1540 (11th Cir. 1989)).

can "strip off" the worthless second mortgage lien.[4]

On December 11, 2013, the bankruptcy court granted Caulkett's motion to determine that Bank of America holds an entirely unsecured claim and to strip off the junior lien under Bankruptcy Code section 506(d). Order, Dec. 11, 2013; Pet. App. 5a. In the proceedings in the bankruptcy court, Bank of America did not dispute the value of the home. Tr. 3:22-23, Dec. 5, 2013 ("Your Honor, we're not challenging the value of the property"); Reply at 1. Nor did it dispute that, if the home were foreclosed, it would receive nothing from a foreclosure sale. The bank simply challenged whether the strip off of its lien is permissible in bankruptcy. On appeal, both the district court and the Eleventh Circuit affirmed the bankruptcy court's order, citing prior circuit precedent. *Bank of Am., N.A. v. Caulkett*, No. 6:14-CV-78-ORL-31, 2014 WL 7175386 (M.D. Fla. Feb. 14, 2014), *aff'd sub nom. In re Caulkett*, 566 F. App'x 879 (11th Cir. 2014).

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[4] Because there is no value to the junior mortgage, Caulkett's debt obligation to Bank of America is unsecured. Accordingly, Caulkett's personal debt to the bank may be discharged in his bankruptcy case as an unsecured liability. 11 U.S.C. §§ 523, 524, 727. The question presented here is whether, notwithstanding the discharge of Caulkett's personal liability to the bank, the bank may keep its lien on the home in order to attempt to collect payment in the future on the basis of its retained lien.

On November 17, 2014, this Court granted certiorari review.

Amicus notes that this case has been consolidated with *Bank of America v. Toledo-Cardona*, no. 14-163. Because the issues in both cases are the same, and because the facts of this case fairly represent how the issues arise generally, *Amicus* does not address separately the facts of *Toledo-Cardona* or refer to them in this brief.

SUMMARY OF THE ARGUMENT

With two exceptions not relevant here, section 506(d) directs: "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." As Justice Scalia observed in his dissent in *Dewsnup v. Timm*, 502 U.S. 410, 420 (1992), whether a particular lien securing a claim is voidable in whole or in part under this provision (i.e., may be "stripped down" to the value of the collateral, or "stripped off" because there is no value in the collateral available to secure the claim) depends on the meaning of the phrase "allowed secured claim." Section 506(a) provides a textual definition:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest
>
> is a secured claim to the extent

> of the value of such creditor's interest in the estate's interest in such property . . and is an unsecured claim to the extent that the value of such creditor's interest . is less than the amount of such allowed claim.

By its terms, section 506(a) commands that, even though an allowed claim may be secured by a lien, the claim is to be treated as wholly *unsecured* to the extent that there is no value in the collateral available to satisfy the creditor's lien at the time of the debtor's bankruptcy. In this case, that perfectly describes Bank of America's junior lien—the value of Caulkett's home is not sufficient to cover the claim of the first mortgagee, leaving no value for Bank of America's junior interest in the collateral. Thus, under section 506(a), Bank of America holds an entirely *un*secured claim, just as the bankruptcy court determined. For purposes of section 506(d), allowed *un*secured claims are obviously not "allowed secured claims" because they are *un*secured. Because the bank's claim is entirely unsecured, there is no warrant in section 506(d) to treat it as secured in any respect, and its lien is thus properly void, as the bankruptcy court held.

Notably, section 506 does not preserve a lien holder's "rights." Elsewhere in the Code, when Congress intended to preserve a lien holder's "rights" in some way (as distinct from its secured

"claim" or the value of its interest in property of the debtor) Congress expressly so provided. *See, e.g.*, 11 U.S.C. § 1322(b)(2) (permitting the modification of the "rights" of the holders of secured claims, other than those secured only by a security interest in the debtor's principal residence). Section 506, however, works differently. As is relevant here, section 506 operates to recognize and preserve liens only to the extent of any *value* in the relevant collateral available to satisfy the claim. Although Bank of America would like to have its non-bankruptcy "rights" preserved, the status of a secured claim (and its associated lien) under section 506 turns on the collateral's "value," not the fact that the bank has lien rights. Where, as here, there is no value to the junior lien under section 506(a), the secured creditor's claim is not "secured" in any respect and the accompanying lien is thus entirely void.

The Court's decision in *Dewsnup* is not to the contrary. *Dewsnup* involved a partially secured claim. Although the value of the collateral in that case was less than the full amount of the relevant debt, nonetheless there was substantial value to the secured creditor's lien interest. In *Dewsnup*, the Court determined that the phrase "allowed secured claim" in section 506(d) encompasses both fully and partially secured claims, stating that the phrase "allowed secured claim" is to be "read term-by-term to refer to any claim that is, first, allowed, and, second, secured." 502

U.S. at 415. Because there was at least some value to the secured creditor's lien interest in *Dewsnup*, the Court concluded that voiding the lien to the extent of any value shortfall would be inappropriate. *Id.* at 417. At the same time, however, the Court was careful to limit its analysis to the precise facts. *Id.* at 416–17 ("We therefore focus upon the case before us and allow other facts to await their legal resolution on another day."). Critically, nothing in *Dewsnup* or section 506 requires or permits the preservation of an entirely valueless lien securing a wholly *un*secured claim. Indeed, the plain command of the statute is to the contrary: the lien is void under section 506(d).

In seeking the preservation of its lien notwithstanding the absence of any value supporting it, Bank of America seeks a priority position contrary to not only the plain text of the Bankruptcy Code but also its fundamental policies. First, the bank's position is at odds with the policy of equality of distribution among creditors. The Code differentiates starkly between secured and unsecured claims. The former are granted priority treatment and a variety of special protections; the latter are not, and generally unsecured claims must share-and-share-alike from often meager distributions from the debtor's bankruptcy estate. By seeking to retain its valueless lien, Bank of America hopes to gain an advantage other unsecured creditors do not en-

joy—the potential right in the future to demand payment from the debtor if, for example, the debtor ever seeks to sell the collateral voluntarily to pay off the first mortgage lien (in which case the bank may demand some payment as the price of its consent to the release of its lien in order to permit the voluntary sale). Because priority provisions in bankruptcy should be tightly construed, Bank of America's interpretation of the statute seeking a priority the text does not state should be rejected.

Second, Bank of America's position is at odds with the Code's fresh-start policy. Although the bank's lien is currently worthless, preserving it would vest the bank with a potent future debt-collection tool it could use to extract payment from the debtor down the road in a variety of contexts. Indeed, that is the only conceivable reason why the bank seeks to retain its lien—to gain some monetary future benefit notwithstanding the current worthlessness of its lien and the dischargeability of its unsecured claim for the amount of its loan. 11 U.S.C. § 727. Because exceptions to the debtor's discharge and the provisions of the Code that support it should be limited to those plainly stated, Bank of America's interpretation of the statute once again should be rejected.

Third, Bank of America's position is at odds with the Code's policy of deleveraging over-

encumbered assets, not only in the reorganization context, but also in liquidation proceedings. Assets that are over-encumbered by worthless liens burden not only the debtor, other creditors, and the bankruptcy estate, but also the marketplace, often necessitating expensive and inefficient state-law foreclosure proceedings that bankruptcy was designed to avoid. Various provisions of the Code operate to deleverage over-encumbered assets so that they may be freed of excessive indebtedness and accompanying liens in order that these assets may be put to productive use short of resort to cumbersome and inefficient state-law foreclosures. *See, e.g.*, 11 U.S.C. § 363(f) (allowing for the sale of property free and clear of liens and other encumbrances). Section 506(d) is one of these provisions. Bank of America, of course, wishes to accomplish precisely the opposite result that these provisions command: to continue to over-encumber the debtor's home for its own financial gain. Because Bank of America's position is fundamentally contrary to the salient bankruptcy policy of disentangling assets from excessive indebtedness, its interpretation of the statute should be rejected.

ARGUMENT

A. Bank of America's Interpretation of Section 506 Is Contrary to Its Text, Context, and History, and the Bank's Reliance on *Dewsnup* Is Misplaced.

1. The Bank's Construction of the Statute Is Contrary to Its Text, Context, and History.

In construing and applying the Bankruptcy Code, "[t]he starting point . is the existing statutory text." *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). In addition, "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotation marks omitted); *see also Rake v. Wade*, 508 U.S. 464, 471 (1993); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). Likewise, the provisions of a statute should be construed together holistically, and not in a disjointed, piecemeal fashion. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369-71 (1988) (construing several sections of the Bankruptcy Code together and observing that "[s]tatutory construction is a holistic endeavor"); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sen-

tence or member of a sentence, but look to the provisions of the whole law ") (citations omitted); *Richards v. United States*, 369 U.S. 1, 11 (1962) ("We believe it fundamental that a section of a statute should not be read in isolation from the context of the whole Act ."). Moreover, they should be construed to avoid rendering any part superfluous. *See, e.g., Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) ("[W]e are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law." (citation omitted)); *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) ("It is the duty of the court to give effect, if possible, to every clause and word of a statute "). In this case, Bank of America's interpretation of section 506 violates all of these principles and is fundamentally unsound.

By its plain terms, section 506(a) acts to sort an "allowed claim" into (1) an "allowed secured claim to the extent of the value of such creditor's interest in the estate's interest in such property" and (2) an "unsecured claim to the extent that the value of such creditor's interest is less than the amount of such allowed claim." 11 U.S.C. § 506(a).[5] Put differently, sec-

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[5] The term "claim" is defined in section 101 of the Code to include a broad assortment of rights to payment, and plainly encompasses the bank's claim in this case. 11 U.S.C. § 101(5). An "allowed" claim is the functional re-

tion 506(a) operates to bifurcate claims accompanied by liens into secured and unsecured portions based upon a judicial valuation of the underlying collateral. *See Nobelman, v. Am. Sav. Bank*, 508 U.S. 324, 328 (1993); *see also Associates Commercial v. Rash*, 520 U.S. 953, 961 (1997) ("[A] secured creditor's claim is to be divided into secured and unsecured portions" and "[t]o separate the secured from the unsecured portion of a claim, a court must compare the creditor's claim to the value of the collateral."); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989) ("Subsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured.").[6] Here, Bank of America's claim is wholly unsecured under section 506(a) because the current monetary value of its lien interest in the debtor's home is zero.

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sult of a claim that has been allowed under the provisions of section 502 of the Code. 11 U.S.C. § 502.

[6] In these and other cases, the Court has recognized a secured creditor's entitlement under the Code to be limited to "the value of its property rights, as measured by the value of its collateral, and not to the *in rem* rights themselves." Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 Cap. U. L. Rev. 313, 313 (1994).

In turn, section 506(d) makes use of the phrase "allowed secured claim" in avoiding worthless liens, stating that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void[.]" 11 U.S.C. § 506(d). The most natural and best reading of subsection (d) is that a creditor's lien is void when its claim is determined (as in this case) to be an "unsecured claim" under subsection (a). This follows not only from the relevant text, but also from examination of the Code as a whole and its relevant legislative history, all of which confirm that Congress intended the phrase "allowed secured claim" used in section 506(d) to have the meaning set forth in section 506(a) and to exclude wholly unsecured claims.

The frequent and consistent pattern of Congress's use of the term "allowed secured claim" throughout the Code indicates that the phrase was intended to be used consistently wherever it appears. The phrase is used in numerous sections of the Code. *See* 11 U.S.C. §§ 348, 506, 524, 722, 724, 1222, 1225, 1325. Moreover, a survey of the usage of the phrase shows that "allowed secured claim" operates throughout the Code in order to achieve particular results that depend upon a consistent meaning—namely the meaning set forth in section 506(a). *Dewsnup*, 502 U.S. *at* 421-22 (Scalia, J., dissenting) (reviewing sections of the Code that use the phrase "allowed secured claim" to reflect the bifurcation process

of subsection 506(a) in 11 U.S.C. §§ 722, 1225(a)(5), 1325(a)(5)).

Likewise, it is clear from the legislative history that Congress intended the phrase "secured claim" to be interpreted consistently as prescribed in section 506(a). As explained in the relevant House Report accompanying the Code, "[t]hroughout the bill, references to secured claims are only to the claim determined to be secured under this subsection [i.e., subsection (a)], and not to the full amount of the creditor's claim." H.R. Rep. No. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312; *see In re Jones*, 152 B.R. 155, 163 (Bankr. E.D. Mich. 1993) (citing legislative history). Review of the Code and its legislative history thus confirms that there is no warrant for the notion that the phrase "allowed secured claim" appearing in section 506(d) somehow permits the preservation of a lien accompanying a claim that is wholly *un*secured under the provisions of section 506(a). In context, the import of the term "secured claim" appearing in section 506(d) directs that, in order to be spared from voidness, a lien accompanying a claim must have at least some value as determined in accordance with section 506(a). Bank of America's contrary argument is unsound because, among other flaws, it effectively reads the word "secured" out of section 506(d) by (at the very least) striving to give it an utterly idiosyncratic meaning divorced from the actual context in which it appears.

If Congress had intended to preserve a creditor's *in rem* lien "rights" accompanying a particular claim notwithstanding the provisions of section 506(d), Congress could easily have done so. For example, using different terms, section 1322(b)(2) (applicable in Chapter 13 cases) permits the modification of the "rights" of the holders of secured claims, *except* those accompanying claims secured only by a lien on the debtor's principal residence. 11 U.S.C. § 1322(b)(2). As the Court observed in *Nobelman*, the specially worded language of section 1322(b)(2) protects the holders of both fully and partially secured claims from lien modification. 508 U.S. at 325-26. *Nobelman* itself, however, strongly suggested that if a claim is completely unsecured, there should be a different result. *See* 8 Collier on Bankruptcy ¶ 1322.06[1][a][i] (15th ed. rev. 2001). Consequently, in Chapter 13 cases, the Code does not preserve lien rights associated with wholly *un*secured claims, and the strip-off of valueless liens is common practice.[7]

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[7] *See Lane v. Western Interstate Bancorp (In re Lane)*, 280 F.3d 663, 668 (6th Cir. 2002) ("[T]he dividing line drawn by § 1322(b)(2) runs between the lienholder whose security interest in the homestead property has some 'value' and the lienholder [who does not]."); *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220 (9th Cir. 2002); *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122 (2d Cir. 2001); *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357 (11th Cir. 2000); *Bartee v. Tara*

If Congress had intended to preserve the lien "rights" of the holders of entirely unsecured claims in Chapter 7 notwithstanding the directive of section 506(d) that liens accompanying claims that are not "allowed secured claims" are void, it could easily have done so. The fact that it did not do so—and indeed used a different series of terms in section 506(d) focusing on value as compared to the "rights" of creditors—illustrates that Congress did not intend the meaning that Bank of America ascribes to section 506. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.") (citation omitted). The bank's erroneous interpretation of the statute should be rejected.

Colony Homeowners Ass'n (In re Bartee), 212 F.3d 277 (5th Cir. 2000); *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606 (3d Cir. 2000); *Domestic Bank v. Mann (In re Mann)*, 249 B.R. 831 (B.A.P. 1st Cir. 2000); *Lam v. Investors Thrift (In re Lam)*, 211 B.R. 36 (B.A.P. 9th Cir. 1997).

2. The Bank's Reliance on *Dewsnup* Is Unsound.

The Court's decision in *Dewsnup* does not compel a different outcome. To begin with, the facts of *Dewsnup* are distinct. There, the dispute involved a single secured creditor holding a partially secured claim against the debtor, and the property in question was headed for foreclosure. *Dewsnup*, 502 U.S. at 412. Here, the dispute involves a wholly unsecured junior creditor seeking to burden the debtor's retention of his home, as well as the debtor's intention of paying the senior secured lender, by seeking to preserve its entirely valueless junior lien. Regardless of whether there is any ambiguity in section 506(d) in the context of its application to a partially secured claim (as in *Dewsnup*), there is no ambiguity in the context of a claim like Petitioner's that is entirely *un*secured. Under no reasonable stretch of the imagination can the phrase "allowed secured claim" be taken to shelter a claim that is entirely *un*secured within the meaning of section 506(a).

Upon closer examination, the Court's various concerns with lien-stripping outlined in *Dewsnup* do not actually favor the bank. Citing the principle that "[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate," *Dewsnup*, 502 U.S. at 419 (citations omitted) (internal quotation marks omitted), the Court in *Dewsnup* observed that, as a general historical matter, liens often passed through

bankruptcy unaffected, *id.* at 418. But in its current form the Code departs significantly from this historic norm and, in fact, the idea that "liens pass through bankruptcy" is now much more the exception rather than the rule.

As the Court observed in *United States v. Ron Pair Enterprises, Inc.* (in which it was called upon to interpret a different provision of section 506), the enactment of the Bankruptcy Code "was intended to modernize the bankruptcy laws, and as a result made significant changes in both the substantive and procedural laws of bankruptcy." 489 U.S. 235, 240 (1989) (citation omitted). And as is particularly relevant here, "Congress intended significant changes [in] the treatment of secured creditors and secured claims." *Id.* (citations omitted) (internal quotation marks omitted). Critically, one of those changes was to abrogate in many respects the idea that liens pass through bankruptcy unaffected.

As explained in the legislative history, section 506—which had no direct antecedent in the former Bankruptcy Act of 1898—"abolishes the use of the terms 'secured creditor' and 'unsecured creditor' and substitutes in their place the terms 'secured claim' and 'unsecured claim.'" H.R. REP. No. 95-595, at 356, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312. Moreover, as the legislative history makes clear:

> The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are under-secured. Current law is ambiguous and vague, especially under Chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that [a partially secured] creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

Id. at 180-81. What this makes plain is that the focus of section 506 is, first, on claims, not rights. Second, the focus is on the "value" of the collateral, not the existence of the lien. Where, as here, there is no value to the particular lien, the claim must be treated as wholly *un*secured and, by operation of section 506(d), the accompanying lien is void.

The Bankruptcy Code ushered in many changes that altered pre-Code practice, including various provisions directing the modification of

secured claims and accompanying liens. For example, lien stripping is permitted in Chapter 11 reorganization cases under section 1129(b)(2), in Chapter 12 cases under section 1225(a)(5), and, as noted, in Chapter 13 cases under section 1322(b)(2). 11 U.S.C. §§ 1129(b)(2), 1225(a)(5), 1322(b)(2). Moreover, in Chapter 7 cases section 506(d) is not the only provision that authorizes Bankruptcy Courts to void liens. For example, contrary to the historic concept that "liens pass through bankruptcy unaffected," certain liens may be voided to the extent they impair a debtor's exemptions, *see* 11 U.S.C. § 522(f), or if they constitute preferences or fraudulent transfers, *see* 11 U.S.C. §§ 547-548. In truth, the new norm in bankruptcy is that, generally speaking, liens often *do not* pass through bankruptcy unaffected.

In *Dewsnup*, the Court was concerned that the debtor might have received a "windfall" if permitted to strip down the creditor's lien to a judicially determined value on the facts presented. In an effort to prevent the debtor from realizing value for herself in the event that the foreclosure value of the property rose above its judicially determined value, the Court reasoned that the creditor's lien should stay with the property unmodified until the foreclosure process was complete. 502 U.S. at 417. But the opposite concern arises when, as here, the junior mortgagee's claim is completely unsecured. By seeking to retain its worthless junior lien, it is the junior mortgagee who seeks a "windfall" in the form of

the power to potentially extract value from the *senior* lien holder in, for example, the short sale context, inverting the priority scheme. The junior mortgagee also seeks the "windfall" of potentially extracting value from the debtor's future earnings, which creditors generally cannot reach in Chapter 7 cases. Fair enough, the debtor may have to pay something for the home in order to keep it out of bankruptcy. But the debtor should not have to pay *more* than the home is worth to the first mortgagee, *and then* still more to the second mortgagee with the entirely worthless junior claim. Nothing in section 506 (or general concepts of equity) supports that result.

In *Dewsnup*, the Court also expressed concern that the retrospective application of the then-novel section 506(d) to strip down the secured creditor's mortgage might have generated a Fifth Amendment problem. 502 U.S. at 419. But whereas the *Dewsnup* mortgage pre-dated the enactment of the Code (thus giving rise to a possible problem if applied retroactively), Bank of America's mortgage loan obviously does not. Moreover, depriving a junior mortgagee of a wholly valueless lien simply cannot constitute an unconstitutional taking: the government is neither required to compensate for value where none exists nor where its intervention is, in the form of some ameliorative scheme like bankruptcy law, what offers the possibility of value that otherwise would not be there (e.g., by the avoidance of value-destroying foreclosure). *See Phil-*

lips v. Washington Legal Found., 524 U.S. 156, 181 (1998) ("And whatever this Court's cases may have said about the constitutional status of such a right, they have *not* said that the Constitution forces a State to confer, upon the owner of property that cannot produce anything of value for him, ownership of the fruits of that property should that property be rendered fertile through the government's lawful intervention." (emphasis in original)). In sum, *Deswnup* is inapposite here and does not genuinely support, let alone compel, the conclusion that a wholly unsecured claim such as the one held by the bank in this case should be treated as an allowed secured claim for purposes of section 506(d).

B. The Bank's Interpretation of Section 506 Is Contrary to the Major Policies of the Bankruptcy Code.

In expounding the meaning of a statute, courts properly look "not only to the particular statutory language, but [also] to the design of the statute as a whole and to its object and policy." *Dada v. Mukasey*, 554 U.S. 1, 16 (2008) (*quoting Gozlon-Peretz v. United States*, 498 U.S. 395, 407 (1991)); *see also Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence but look to the provisions of the whole law, and to its object and policy." (citation omitted)). In this case, Bank of America's position is contrary not only to the text, context, and history of section 506, but also

to several important bankruptcy policies. For this reason as well, the bank's argument is unsound.

1. The Bank's Approach Contravenes the Policy of Equality of Treatment Among Creditors.

As the Court has long recognized, one of the fundamental policies of the Bankruptcy Code is the concept of equality of distribution among creditors. *See, e.g.*, *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (discussing "the prime bankruptcy policy of equality of distribution" to creditors); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets "); *Buchanan v. Smith*, 83 U.S. 277, 301 (1872) (noting the main bankruptcy policy of "[e]qual distribution of the property of the bankrupt, *pro rata*"). Because Bank of America holds an entirely unsecured claim, the lot of the general unsecured creditor is all that it is entitled to enjoy—unless, of course, some provision of the Code affirmatively grants it special treatment. *See, e.g.*, 11 U.S.C. § 507. No provision, however, does so in this instance, and the bank's effort to conjure up priority treatment for itself through its strained interpretation of section 506 should be rejected.

Because the priority treatment of a particular creditor's claim undermines the general policy of equality of distribution, the Court has long followed the principle that the Code's priority provisions should be construed narrowly, disfavoring priorities that are not clearly articulated. *See Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 667 (2006). For example, relying specifically on the Code's aim "to secure equal distribution among creditors," the Court declined in *Howard Delivery* to afford priority status to premiums paid for workers' compensation insurance, even though these arguably fell within the reach of the priority provision in question. *Id.* at 655. The Court explained that the equal distribution objective produces the "corollary principle that provisions allowing preferences must be tightly construed." *Id.* at 667; *see also Nathanson v. NLRB*, 344 U.S. 25, 29 (1952) ("The theme of the Bankruptcy Act is 'equality of distribution' and if one claimant is to be preferred over others, the purpose should be clear from the statute." (quoting *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) (explaining that in light of the bankruptcy theme of equality of distribution "an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice."))); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930) ("The broad purpose of the Bankruptcy Act is to bring about an equitable distri-

bution of the bankrupt's estate . [and] [a]ny agreement which tends to defeat that beneficent design must be regarded with disfavor."); 4 Collier on Bankruptcy ¶ 507.01 (16th ed. 2012) ("Because priorities grant special rights to the holders of priority claims, priorities under the Code are to be narrowly construed.").

Section 506 is a priority provision. It confers secured status on a claim to the extent the claim is accompanied by a lien and the lien has value as determined under the protocol in section 506(a). In challenging the decisions below, Bank of America offers a remarkably generous construction of section 506 that, if accepted, would clothe its entirely unsecured claim with at least some of the advantages of secured status, even though its claim does not qualify for secured treatment. That result is precisely the opposite of that directed by the Court in cases such as *Howard Delivery*. Because the bank's strained interpretation of the statute runs afoul of this longstanding approach and the salient bankruptcy policy it serves, it should be rejected.

2. The Bank's Approach Contravenes the Policy of Providing Honest but Unfortunate Debtors with a Fresh Start.

As the Court has long recognized, a second "principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortu-

nate debtor'" in the form of a discharge of the debtor's preexisting debts. *Marrama v. Citizens Bank*, 549 U.S. 365, 367 (2007) (citation omitted); *see also Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fid. & Guar. Co.*, 236 U.S. 549, 554–55 (1915) (observing that the debtor's discharge is designed to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh")). As this Court has also observed, "[t]he discharge of the debtor has come to be an object of no less concern than the distribution of his property." *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935). Indeed, as the Court explained in an early case under the Bankruptcy Act of 1898:

> The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a main purpose of the act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors. Our decisions lay great stress upon this feature of the law

Stellwagen v. Clum, 245 U.S. 605, 617 (1918).

Because the fresh start is so central and important to the administration of the bankruptcy system, it is unsurprising that the Court has held that procedures and exceptions that burden the debtor's discharge should be construed narrowly and likewise limited to those plainly expressed. *See Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754, 1760 (2013) (noting "the long-standing principle that exceptions to discharge should be confined to those plainly expressed") (citations omitted) (internal quotation marks omitted); *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998); *see also Local Loan Co.*, 292 U.S. at 245 ("The various provisions of the Bankruptcy Act were adopted in the light of [the 'fresh start' policy] and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act.").

In this case, the bank plainly seeks to burden the debtor's discharge by preserving its payment leverage associated with its lien rights, even though its claim is wholly unsecured and the debt it represents is completely dischargeable—indeed, that is the whole point of its effort to avoid the application of section 506(d). To get around section 506(d), the bank relies on an exceedingly ambitious interpretation of the statute. The bank's interpretation, however, stands at odds with the principle that, unless plainly stat-

ed, ambitious constructions of the Code that burden the discharge are disfavored. Because the bank's construction is not plainly stated—indeed, it is not stated at all—it should be rejected.

3. The Bank's Approach Contravenes the Policy of Deleveraging Over-encumbered Assets.

Finally, a third relevant policy of the Code is the policy of disencumbering overleveraged assets. Several of the Code's provisions are specifically designed to remove encumbrances from the debtor's assets, such as liens and the like, so that these assets may be more readily deployed, either by the debtor or a purchaser. *See, e.g.*, 11 U.S.C. §§ 363(f) (providing for the sale of property free and clear of interests), 522(f) (providing for the removal of certain liens that impair the debtor's exemptions), 1123(a)(5)(D) (providing that a Chapter 11 plan may provide for the sale of the debtor's assets free of any lien). Section 506(d) is one of these provisions.

The policy behind the Code's encumbrance deleveraging provisions is straightforward. Assets that are over-encumbered with liens and the like are a burden to the debtor, creditors, the bankruptcy process, and the marketplace in general. For example, even if the debtor or trustee wishes to sell in bankruptcy an asset worth $1 million, no purchaser would pay anything for the

asset if it remained encumbered with $10 million in liens. To avoid this problem and permit the efficient sale of assets free of liens, Congress included with the Code section 363(f) cited above. Similarly, exempt property is worth less to the debtor if it remains encumbered with judicial liens and the like. To enhance the value of the debtor's exempt property, Congress included section 522(f) cited above. Section 506(d) has a similar office: to deleverage liens associated with unsecured claims as determined under the protocol established in section 506(a), regardless of whether the property is to be sold or retained by the debtor.

In this way, bankruptcy law aims to avoid state-law foreclosure procedures, and the reason for this is also straightforward: foreclosure liquidations typically realize lower prices and generate other problems. *See, e.g.*, *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) ("[P]roperty that must be sold [through a state-law foreclosure procedure] is simply worth less" because "[n]o one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques." (emphasis omitted)). As one commentator has summarized: "[e]stimates suggest that a typical home loses something like half its value when it goes into foreclosure In addition, foreclosures disrupt lives, create neglected properties, and leave whole neighborhoods suffering." Alan S. Blinder,

After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead 321 (2013). For this reason, foreclosures are to be avoided. *Cf. United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) ("Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap'").

In this case, Caulkett wishes to retain his home and is willing to pay the senior lender more than it is worth to do so. This represents a value-maximizing transaction that has the effect of avoiding the foreclosure of the home and all of its attendant value-destroying consequences. Although Bank of America's lien is worthless, it still represents a form of leverage that the bank might use for its own financial gain, but its value to the bank lies solely in the costs the lien can impose on the debtor and the senior lender. Because preserving the lien is contrary to the policy behind the Code's deleveraging provisions, including section 506(d), the bank's interpretation of section 506(d) should be rejected.

CONCLUSION

For the foregoing reasons, as well as those briefed by Respondent, the decision of the court below should be AFFIRMED.

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IN THE

Supreme Court of the United States

BANK OF AMERICA N.A., *PETITIONER*,

v.

DAVID B. CAULKETT, *RESPONDENT*.

BANK OF AMERICA N.A., *PETITIONER*,

v.

EDELMIRO TOLEDO-CARDONA, *RESPONDENT*.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF OCCUPY THE SEC AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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STATEMENT OF INTEREST

Occupy the SEC ("OSEC") is a nonprofit advocacy group within the New York-based Occupy Wall Street movement.[1] OSEC's mission is to advocate for specific improvements to legislations and regulations governing the financial services industry. We seek to ensure that the nation's laws serve the public interest, and not that of Wall Street and its lobbyists. Our group has previously filed *amicus curiae* briefs in court cases that raise significant issues of concern for financial activists, including the recent Supreme Court cases *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) and *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014).

OSEC submits this brief in support of Respondents and the holdings of the Eleventh Circuit in the decisions below, which were premised on *McNeal v. GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012) and *In re Folendore*, 862 F.2d 1537 (11th Cir. 1989). The instant case centers on a key provision of the Bankruptcy Code, § 506. The Respondents propound the correct interpretation of the phrase "allowed secured" in § 506(d), which plainly permits the strip-off of a wholly underwater lien during Chapter 7 liquidation.

Misconduct in the mortgage industry played a pernicious role in bringing about the recent financial crisis of 2008. That crisis destabilized the global economy and devastated the economic position of millions of home-

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[1] The parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person, other than amicus curiae or its members made a monetary contribution to the preparation or submission of this brief.

owners, forcing many to pursue bankruptcy protection from the demands of creditors.

OSEC files this amicus brief to advocate for the interests of economically vulnerable debtor-homeowners, whose access to justice would be severely limited if the Court were swayed by the Petitioner's flawed interpretation of the phrase "allowed secured" in § 506(d).

Chapter 7 victims are placed in a vulnerable position after losing essentially everything they have. The Court has long acknowledged that debtors who are undergoing liquidation should be afforded a fresh start after bankruptcy. Our governmental system must protect our rights,[2] and we ask the Court to serve the best interests of the people by interpreting § 506(a) and § 506(d) together so as to allow strip-off of wholly underwater liens. This outcome is essential because it would protect liquidation debtors from unjust foreclosure and collection on liens that have no present value.

SUMMARY OF ARGUMENT

The Court should read § 506(a) and § 506(d) of the Bankruptcy Code together in order to arrive at the correct interpretation of the term "allowed secured" in § 506(d). Under the plain language of these provisions, a completely underwater junior lien must be voided as part of the Chapter 7 bankruptcy process. Even subsection (d) alone expresses a clear intention to void liens "to the extent" that they are not secured in collateral value.

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[2] *See* Occupy Wall Street, Declaration of the Occupation of New York City (2011), *available at* http://www.nycga.net/resources/declaration/.

While the Petitioner cites *Dewsnup v. Timm*, 502 U.S. 410 (1992) to support its reasoning, the Court in that case carefully (and repeatedly) limited its decision's precedential impact to the specific fact pattern presented in that case. Thus, *Dewsnup* is inapposite to the case at bar.

The Petitioner recognizes that the phrase "allowed secured" in § 506(d) establishes two separate requirements for a lien to survive voidance: first, the associated claim must be "allowed" under § 502, and second, the claim must be "secured." Despite this recognition, the Petitioner glosses over the second requirement, making the simplistic argument that a lien's status *as such* is sufficient to satisfy the securedness requirement. The *Dewnsup* decision followed similarly erroneous reasoning.

The legislative history behind the enactment of § 506 reveals that subsections (a) and (d) were meant to be read collectively, with securedness corresponding to collateral value. This is demonstrated in various passages in the House and Senate reports accompanying the passage of the Bankruptcy Code in 1978. Therefore, any ambiguities in interpreting § 506(d) can be solved by reading it in conjunction with § 506(a).

Moreover, numerous policy considerations militate in favor of strip-off of wholly underwater liens. The Bankruptcy Code was passed with the intention of reorienting the bankruptcy regime to be more protective of debtors and their right to an unencumbered fresh start. Thus, while a debtor's property could conceivably appreciate in value after a liquidation and discharge, such post-petition appreciation rightly belongs to the debtor under fresh start principles. Allowing an unsecured lienholder to partake in post-

petition appreciation would mean granting it a windfall, especially because other unsecured creditors would be denied that opportunity. Moreover, it is far from certain that a debtor's property value would ever increase enough to resuscitate an unsecured lienholder's otherwise-valueless lien.

Economic analysis reviewing the impact of *Dewsnup* and other lien-stripping cases on the mortgage market reveals that debtors would benefit from strip-off of wholly underwater second liens, while lenders would be no worse off (if not better off). Furthermore, the Court should take cognizance of the role that lenders played in producing the dismal economic conditions that have forced millions of people into bankruptcy and foreclosure in recent years.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 506 SUPPORTS AFFIRMANCE

Under a plain reading of 11 U.S.C. § 506 of the Bankruptcy Code, a completely underwater junior lien is voided in a Chapter 7 liquidation. The explicit language of a statute controls over secondary considerations like legislative history and public policy. *See United States v. Ron Pair Enters. Inc.*, 489 U.S. 235, 241 (1989).

Section 506(d) states that a lien is void if it "secures a claim against the debtor that is not an allowed secured claim." The instant case turns on the exact meaning of the phrase "allowed secured" in § 506(d). The Petitioner, citing *Dewsnup*, 502 U.S. at 415, concedes that these two "words should be read term-by-term to refer

to any claim that is, first, allowed, and, second, secured." Pet. Br. 22. That is, a lien will be void under § 506(d) to the extent that it secures a claim that is *either* disallowed *or* not secured. There is no dispute that § 502 dictates whether a claim is "allowed." Pet. Br. 32. Thus, the only real question is what constitutes a "secured" claim under § 506(d).

The Court need look no further for an answer than three subsections earlier in the same statute, § 506(a). That subsection of § 506 clarifies that a lienholder has a "secured" claim for the amount of the lien up to the value of the collateral (and an unsecured claim for the remainder). Thus, a claim that corresponds to zero value in the collateral cannot be "secured," and the lien attached to that claim must be voided under § 506(a).

A. *Dewsnup* is Inapposite on its Own Terms

Citing *Dewsnup*, the Petitioner champions a strained reading of § 506 that would have this Court completely ignore § 506(a) in construing § 506(d). Pet. Br. 22. The Petitioner's reliance on *Dewsnup* is inapposite, as that case dealt with a secured claim corresponding to collateral with diminished value, whereas the instant matter deals with a claim that is not secured by any collateral value whatsoever. *See McNeal*, 735 F.3d at 1265 (noting that *Dewsnup* has precedential value in lien "strip-down" cases, not "strip-off" ones).

Importantly, *Dewsnup* by its *own terms* did not seek to apply its interpretation of § 506(d) to "all possible fact situations," leaving such "other facts to await their legal resolution on another day." 502 U.S. at 416-17. Indeed, *Dewsnup* (while paradoxically holding to the contrary) admitted that the better view was for "al-

lowed secured" to take the same meaning in § 506(d) as in § 506(a). 502 U.S. at 417. ("Were we writing on a clean slate, we might be inclined to agree . . . that the words 'allowed secured claim' must take the same meaning in § 506(d) as in § 506(a)."). Thus, the Petitioner's exhortations regarding the *stare decisis* effect of *Dewsnup*, Pet. Br. 30, 40, are misplaced. *See Hoover v. Wise*, 91 U.S. 308, 313-14 (1875) (recognizing the simple axiom that cases "in which the point before [the Court] was not raised or brought to the notice of the court. . . . are not authority on the point.").

B. A Lien Must be Tied to a Claim that is Both Allowed and Secured to Escape Voidance Under Section 506(d)

The Petitioner correctly acknowledges that the phrase "allowed secured" in § 506(d) establishes two requirements for a lien to survive voidance: first, the underlying claim must be "allowed" under § 502, and second, the claim must be "secured." Pet. Br. 22. However, the Petitioner's subsequent reasoning gives short shrift to the second requirement. Bank of America takes the absurd view that a lienholder with an allowed claim *always* has a "secured" claim for purposes of § 506(d), irrespective of whether any collateral is available to actually secure that claim. *See* Pet. Br. 22. This interpretation reduces the word "secured" in "allowed secured" into a nullity and a superfluity.

Under the Petitioner's reasoning, the effect of § 506(d) would be no different whether that statute referred to "an allowed secured claim" or "an allowed claim." Either way, a lien could only be voided under § 506(d) if the underlying claim were disallowed under §

502. The Court must not assume that Congress included the term "secured" in § 506(d) out of mere verbosity. *See Market Co. v. Hoffman*, 101 U.S. 112, 115 (1879) ("As early as in Bacon's Abridgment, sect. 2, it was said that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant'").

The Petitioner's reasoning attempts to "strip-off" any real meaning from the word "secured" in § 506(d)[3] – a meaning that is readily supplied by § 506(a). The Petitioner's *reductio ad absurdum* cannot be countenanced under long-standing principles of statutory interpretation. *See Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) (holding that an unnatural meaning should be disfavored at any time, but particularly when it produces a redundancy).

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[3] The Petitioner's reasoning mirrors that of *Dewsnup*, which similarly attempted to efface the iteration of "secured" in § 506(d) out of existence. *Dewsnup*'s express adoption of a two-step analysis of "allowed secured" actually undermined its own holding. *Dewsnup* might have been logically consistent if it had reduced the phrase "allowed secured" into "allowed," but the decision actually took pains to establish a two-step process whereby each term in the phrase would be considered separately. *Dewsnup*, 502 U.S. at 415. After doing so, the decision summarily disregarded the second step in that process, deferring instead to questionable policy concerns. *See id.* There is no wonder then that *Dewsnup*'s reasoning has been subject to intense criticism in the Chapter 7 context, *see, e.g.*, Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. Bankr. L. & Pract. 513 (1992), and has "lost every game it has played" outside of the liquidation arena. *In re Woolsey*, 696 F.3d 1266, 1276 (10th Cir. 2012).

C. Voidness in Section 506(d) is a Matter of Degree

The surrounding context of the phrase "allowed secured" in § 506(d) also sheds light on the proper meaning of those words. Section 506(d) states that a lien is void "to the extent" that it secures a claim that is not an allowed secured claim. The fact that the statute uses the modifier "to the extent" instead of "if" suggests that voidness is a matter of degree. *See Dewsnup*, 502 U.S. at 424 (Scalia, J., dissenting) ("[A] lien only 'secures' the claim in question *up to the value* of the security that is the object of the lien—and only *up to that value* is the lien subject to avoidance under § 506(d)." (emphasis added)). The "extent" of voidness corresponds to the "extent" of securedness. Thus, where a claim underlying a lien is mostly secured, there is little voiding effect. And where a leinholder's claim is not secured by any value, the lien is fully voided. Under the Petitioner's view, the options for lien voidance under § 506(d) are binary. Pet. Br. 25. Either a claim underlying a lien is allowed, or it is not—voidness follows suit. However, this simplistic either-or approach is at odds with the graduated approach adopted by Congress in choosing the words "to the extent."

II. CONGRESS INTENDED FOR SECTIONS 506(A) AND 506(D) TO BE READ TOGETHER

The Petitioner echoes *Dewsnup* in claiming that the word "secured" in § 506(d) means something different than in § 506(a). *See* Pet. Br. 21-22 (citing U.S. 520 at

415). However, that claim is undermined by a review of the legislative history behind the passage of § 506, which reveals that subsections (a) and (d) were meant to be read together. Both the Senate and the House reports state that "*[t]hroughout the bill*, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim." S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978) (emphasis added); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 356 (1978) (emphasis added). Thus, the term "secured" in subsection (d) was meant to have the same definition as in subsection (a).[4]

The Petitioner notes that Congress has not amended § 506 of the Bankruptcy Code in the twenty years since the *Dewsnup* holding, and claims that that fact evidences Congress's implicit acquiescence to *Dewsnup*'s reading of § 506(d). Pet. Br. 40. However, mere nonaction does not equal acquiescence or outright approval. This Court has long-ago observed that "it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law." *Girouard v. United States*, 328 U.S. 61, 69 (1946). "It is 'impossible to assert with any degree of assurance that congressional failure to act represents' affirmative congressional approval of the Court's statutory interpretation." *Patterson v. McLean Credit Union*, 491 U.S. 164,

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[4] This point is further corroborated by the House Report's discussion of a separate provision, § 502(b)(7), which relates to voidance of a landlord's security interest: "By virtue of proposed 11 U.S.C. **506(a) and 506(d)**, the claim will be divided into a secured portion and an unsecured portion in those cases in which the deposit the landlord holds is less than his damages." H.R. Rep. No. 95-595, at 354 (emphasis added).

175 n.1 (1989) (quoting *Johnson v. Transportation Agency, Santa Clara Cty.*, 480 U.S. 616, 672 (1987) (Scalia, J., dissenting))).

Indeed, one can just as easily use similar reasoning to reach the opposite conclusion. Despite passing amendments to the Bankruptcy Code in 1986, 1994 and 2005, Elizabeth Warren & Jay Lawrence Westbrook, *The Law of Debtors & Creditors* 104-06 (6th ed. 2009), Congress has never found it necessary to clarify the ostensible ambiguity in § 506. That non-action calls into question whether any ambiguity ever existed in the first place. Furthermore, as explained above, under the Petitioner's view, § 506(d) would have the same legal effect regardless of whether it predicated immunity from lien voidance on the underlying claim's status as an "allowed secured claim" *or* an "allowed claim." *See* Pet. Br. 25-26. Yet, in the near forty years since the institution of § 506(d), Congress has never once ratified that view by removing the assertedly-superfluous word "secured" from the phrase "allowed secured claim."

The Petitioner also claims that the original version of § 506(d) "made clear that a lien was not voided unless a party in interest had objected to the claim and the court had affirmatively disallowed it." Pet. Br. 33. The originally introduced § 506(d) stated:

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless (1) a party in interest has not **requested that the court determine and allow or disallow** such claim under section 502 of this title;

> or (2) such claim was disallowed only under section 502(e) of this title.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 506(d), 92 Stat. 2549, 2583 (emphasis added).

Contrary to the Petitioner's claim, the above passage actually states that a lien can only be voided if the claim has undergone the allowance determination process under § 502. Under a simple reading of this original language, either an allowed *or* disallowed claim could be voided. The current version of the statute is not materially different.[5]

Both the Petitioner and the *Dewsnup* majority focused a significant part of their arguments on the proposition that all liens pass through Chapter 7 liquidation unaffected. Pet. Br. 34 ("At least in liquidation proceedings like those here, 'liens pass through bankruptcy unaffected.'" (citing *Dewsnup*, 502 U.S. at 417)). This proposition is predicated upon a misconstrued single line in the House Report, which states that "[s]ubsection (d) permits liens to pass through the bankruptcy case unaffected." H.R. Rep. No. 95-595, at 357.

While liens do enjoy special treatment in bankruptcy, the simple fact is that all liens do *not* pass through liquidation unaffected. Both the Petitioner and *Dewsnup* have implicitly acknowledged this fact (and have thereby contradicted themselves) given their recognition that liens attached to disallowed claims are

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[5] *See* 11 U.S.C. § 506(d) (voiding a lien securing a claim under certain circumstances, unless "such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501").

voided under § 506(d).[6] There is no disagreement among the parties that *at least some* liens do not survive the liquidation process, pre-Code practice notwithstanding. Indeed, numerous other provisions under Chapter 7 of the Code allow for lien voidance.[7]

One such provision is § 506, the plain text of which mandates the voidance of liens that are attached to claims that are not secured by collateral value. The Petitioner argues that the term "secured" in § 506(d) is "ambiguous in isolation," because it could mean secured in the sense of corresponding to collateral value, or secured in the sense of having an attached lien. Pet. Br. 30 (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)). Even assuming such ambiguity exists, the very case cited by the Petitioner instructs that such ambiguity can be satisfactorily resolved if "the same terminology is used elsewhere in a context that makes its meaning clear." *Timbers*, 484 U.S. at 371. Here, the term "secured" is

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[6] *See* Pet. Br. 33 ("§506(d) addresses what happens if a secured creditor's claim is disallowed: In that event, because the underlying debt has been determined to be invalid, the lien securing the debt is voided as well."); *Dewsnup*, 502 U.S. at 417; *see also id.* at 434 (Scalia, J., dissenting) ("[N]o matter how deeply one admires and venerates 'pre-Code law,' it is impossible to interpret § 506(d) in a manner that entirely preserves it—and the Court itself, for all its protestation of fealty, does not do so. No provision of the former Bankruptcy Act, nor any pre-Code doctrine, purported to invalidate—across the board—liens securing claims disallowed in bankruptcy[.]").

[7] *See, e.g.*, 11 U.S.C. §522(f) (extending the rights of debtors to avoid liens against exempt property); *id.* §544(a) (avoiding unperfected security interests).

used nearby, in § 506(a), in a context that clarifies any ambiguity over the meaning of "secured" in § 506(d).

Even if pre-Code practice had contained a blanket prohibition on lien-stripping, that historical practice would still remain unavailing to the Petitioner because prior policy cannot trump a more recent statutory mandate. Generalizations about legislative history are inadequate to "overcome the plain textual indication" of statutory language. *Timbers*, 484 U.S. at 380. Indeed, as Justice Scalia noted in his *Dewsnup* dissent, the Court has never held pre-Code practice to be determinative in the face of contradictory statutory text. *Dewsnup*, 502 U.S. at 433 (Scalia, J., dissenting).

Pre-Code practice is also irrelevant given the historical fact that the Bankruptcy Code was enacted in 1978 with an express intention to reduce the rights of lienholders vis-à-vis debtors. *See* Howard, *Dewsnupping the Bankruptcy Code*, at 527 n.74 ("The Code was understood at the time of its enactment not to be as solicitous of secured creditors as pre-Code law had been[.]"). This reorientation is manifested in Section 506(a), which dilutes a lienholder's interest into secured claims and unsecured ones. This framework protects lienholders only to the extent of collateral value,[8]

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[8] The House Report contains the following illuminative passage:

> One of the more significant changes from current law in proposed Title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are undersecured. Current law is ambiguous and

without over-privileging their mere status as holders of liens "with recourse to the underlying collateral." Pet. Br. 20.

Thus, a more accurate restatement of the treatment of liens would be that they pass through liquidation unaffected, *provided* that some provision of the Bankruptcy Code does not void them. *See* Howard, *Dewsnupping the Bankruptcy Code*, at 526 n.71.

Furthermore, a close reading of the House Report for the Bankruptcy Code undermines the Petitioner's contention that Congress intended to circumscribe § 506(d) voidance to liens tied to disallowed claims. The Report states that "if a party in interest requests the court to determine and allow or disallow the claim secured by the lien under section 502 and the claim is not allowed, then the lien is void to the extent that the claim is not allowed." Pet. Br. 34 (citing H.R. Rep. No. 95-595, at 357); *see also* S. Rep. No. 95-989, at 68 ("Subsection (d) provides that to the extent a secured claim is not allowed, its lien is void[.]"). This passage stands for the unremarkable proposition that a lien tied to a disallowed claim is voided under § 506(d). That passage does not address (and thereby logically permits) the possibility that *allowed* claims could *also* be voided

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> vague, especially under Chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral and an unsecured claim for the balance of his claim against the debtor.

H.R. Rep. No. 95-595, at 180-81 (emphasis added).

under certain circumstances, such as for failing to be secured in collateral. Instead, the passage is focused solely upon the first component of the pivotal phrase "allowed secured," which both *Dewsnup* and the Petitioner recognize as a single phrase composed of two legally distinct words. *See* Pet. Br. 22; *Dewsnup*, 502 U.S. at 415 ("[T]he words should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured."). The contours of the second word in the phrase "allowed secured" are amply delineated earlier in the same House Report, which explains that "*[t]hroughout the bill*, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim." H.R. Rep. No. 95-595, at 356. This statement demonstrates Congress's intention to void certain liens where their associated claims are not "secured" in collateral.

III. POLICY CONSIDERATIONS FAVOR AFFIRMANCE

A. Fresh Start Principles Support Strip-off of Underwater Second Liens

For well over a century, the Court has recognized the fundamental principle that debtors undergoing liquidation should be afforded a fresh start after bankruptcy.

> The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a main purpose of the act, intends to aid the

> unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors. Our decisions lay great stress upon this feature of the law — as one not only of private but of great public interest in that it secures to the unfortunate debtor, who surrenders his property for distribution, a new opportunity in life."

Stellwagen v. Clum, 245 U.S. 605, 617 (1918).

To be sure, it is clear that liens are not voided by the mere initiation of a liquidation proceeding. *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991). However, this Court is now presented with the less obvious question of whether to allow strip-off of completely underwater second mortgages under § 506(d). As noted by the Petitioner, millions of homeowners are saddled with partially or wholly underwater junior mortgages, Pet. Br. 16-17, and a sizeable portion of that number may be facing the prospect of bankruptcy. The financial difficulties of this population mirror those of the broader economy, which has suffered a catastrophic downturn propelled in large part by eroding housing and mortgage markets. *See generally* The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011) ("FCIC Report"). The stripping off of economically worthless junior mortgages would grant the "unfortunate debtor" a truly unfettered "new opportunity in life," *Stellwagen*, 245 U.S. at 617, which is a timely and

laudable policy objective given the recent history of financial turbulence. The public interest would not be served by an adoption of the Petitioner's view, which would unconscionably permit a junior mortgagee to dun a debtor with the specter of foreclosure even when the present value of the mortgagee's interest is essentially zero.

In *Dewsnup*, this Court observed that the fresh start policy does not extend to *in rem* claims against property but rather is limited to discharge of personal liability. 502 U.S. at 418 (citing *Johnson*, 501 U.S. at 84). However, *Dewsnup* and *Johnson* dealt with senior liens, whereas the present case focuses solely upon junior liens. Many junior liens essentially serve as home equity loans intended to facilitate *personal* spending. *See In re Bartee*, 212 F.3d 277, 293 (5th Cir. 2000) ("[S]econdary lending is targeted primarily at personal spending"). Therefore, the policy of preserving *in rem* liability should serve as less of a restriction on the Court's due consideration of the fresh start policy in deciding this case.

B. Postpetition Appreciation in Collateral Value Belongs to the Debtor

A key policy issue in this case is which party — lienholder or debtor — is entitled to increases in collateral value after bankruptcy ("postpetition appreciation"). In the normal case, where a lien is tied to an allowed and secured claim, the lien stays with the real property until the foreclosure or payment in full, and any appreciation in the property's value accrues to the benefit of the lienholder in the event of foreclosure. Pet. Br. 22 (citing *Dewsnup*, 502 U.S. at 417 ("Any increase over

the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor[.]")). As the Petitioner notes, "that is what it means to have a lien." *Id.* at 4. However, the lienholder's right to postpetition appreciation evaporates where a lien is rightfully stripped during the liquidation process for having no corresponding collateral value. That is what it means for a lien to be voided under the plain language of § 506. It would be unfair to both debtors and the broader class of unsecured creditors for lienholders to enjoy postpetition appreciation, at least in cases where the lienholder's claim is completely underwater.

As noted above, a fundamental objective of the Bankruptcy Code is to "aid the unfortunate debtor by giving him a fresh start in life." *Stellwagen*, 245 U.S. at 617. This hallowed fresh start policy militates in favor of speedy and expeditious disposition of debts. *See In re Dittmar*, 618 F.3d 1199, 1212 (10th Cir. 2010) (recognizing the overriding policy "that bankruptcy cases be handled in a speedy and expeditious manner") (internal citation omitted). Thus, a Chapter 7 debtor is entitled to have his debts resolved to the maximum extent possible during a single liquidation proceeding. Truly secured property rights must be firmly and finally winnowed from unsecured ones. The Bankruptcy Code was not written for the purpose of preserving essentially dead liens based upon the purely hypothetical possibility of postpetition appreciation.

Rather, the intent of Congress in formulating the country's bankruptcy regime has been "to leave the bankrupt free after the date of his petition to accumulate new wealth in the future," and thus "make an unencumbered fresh start." *Segal v. Rochelle*, 382 U.S. 375, 380 (1966). Allowing lienholders to retain value-

less liens flies in the face of this policy, and hampers debtors' ability to accumulate new wealth in the form of increased home equity after having passed through Chapter 7 liquidation.

The Petitioner suggests that the housing market has improved since the nadir of 2008, and that as a result, underwater liens are regaining equity. Pet. Br. 16. While that may be true, the issue before this Court is whether § 506 renders a lien voidable for being *presently* unsecured. The language of Section 506 countenances no consideration of the possibility that an offending lien might somehow become secured *in the future*. If a lienholder's claim is not "secured" during a Chapter 7 proceeding, the associated lien is voided then and there.

If a mortgagee's completely underwater lien were preserved in the liquidation process, that mortgagee would unfairly be allowed to "have its cake and eat it too." First, the mortgagee could share in the proceeds of the distribution *in pari passu* with other unsecured creditors under § 506(a). Second, the mortgagee could benefit from any postpetition appreciation in the collateral pursuant to a foreclosure. This result would run afoul of the basic bankruptcy tenet that creditors of equal priority should receive equal pro rata distributions. *Begier v. IRS*, 496 U.S. 53, 58 (1990); *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (recognizing that equality of distribution among creditors is "prime bankruptcy policy"). A completely underwater mortgagee, *as an unsecured creditor*, must receive distributions on par with other unsecured creditors even if those other unsecured creditors "had nothing to do

with the mortgagor-mortgagee bargain." *Dewsnup*, 502 U.S. at 417.[9]

In any case, it is far from certain that collateral will appreciate in value after bankruptcy. And even if there were a postpetition increase in collateral value, the senior lienholder would have priority over a wholly unsecured junior lienholder to collect that increase. Consider, for example, a debtor like the one in *Dewsnup* who owes $119,000 to a senior lienholder, and owns collateral with a present value of $39,000. Assume a junior lienholder holds a junior claim for $20,000. In this example, the senior lienholder is undersecured by $80,000, which means that the property would need to appreciate by more than that amount after bankruptcy — a tall order — for the junior lienholder to enjoy any benefit whatsoever from its unvoided lien. Thus, it is quite likely that a bank holding a wholly unsecured junior lien would be no worse off from a stripoff of that lien, *even if* the collateral were to later appreciate in value. Liens of this type are "empty legal rights" that are not worthy of vindication. *See In re Tanner*, 14 B.R. 933, 938 (Bankr. W.D. Penn. 1981).

The Petitioner and their amici express concern that the decision below abrogates state-law property rights. *See* Pet. Br. 31; Loan Syndications and Trading Association et al. Am. Br. 9. Yet even these parties must concede the rudimentary point that federal law preempts state law. Section 506 of the Bankruptcy Code, and not state law, determines whether a lien may be voided for failing to be secured. This Court has recog-

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[9] Indeed, most unsecured creditors have nothing to do with each other's bargains.

nized that bankruptcy law should only respect the allocation of property rights under state law so long as no "federal interest requires a different result." *Butner v. United States*, 440 U.S. 48, 55 (1979). Here, the hallmark principles of creditor equality and a debtor's right to a fresh start are those superseding federal interests. *Stellwagen*, 245 U.S. at 617; *see also Union Bank*, 502 U.S. at 161.

C. Strip-off of Underwater Liens Would Benefit the Economy

A wholly underwater second lien has virtually no present economic value, and is little more than the naked right to foreclose. The stripping off of such liens under § 506(d) would not only improve the financial position of bankruptcy debtors, but would also have salutary effects on local economies ravaged by foreclosures in the recent housing crisis.

Current estimates indicate that there are approximately 2.1 million underwater borrowers holding both first and second liens.[10] The average mortgage balance for this group of borrowers is $299,000 and the average underwater amount is $78,000. Of these millions of borrowers, a significant number may be at risk of imminent default and possible foreclosure.

While foreclosure at a certain level may be the natural consequence of normal housing market conditions, excessive foreclosures produce negative externalities

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[10] CoreLogic, *CoreLogic Reports 273,000 Residential Properties Regained Equity in Q3 2014* (Jan. 8, 2015), *available at* http://www.corelogic.com/about-us/news/corelogic-reports-273,000-residential-properties-regained-equity-in-q3-2014.aspx.

that depress local economies.[11] Foreclosed homes can produce urban blight that reduces the property value of adjacent homes. That can set off a perverse domino effect whereby even more homeowners sink underwater and face the risk of foreclosure. Reduced property values also cause local governments to lose property tax revenue and force cuts to spending on local public goods. It is no wonder then, that Congress has passed anti-foreclosure legislation with the express purpose of improving the economy and allowing the country to push past the recent recession. *See, e.g.*, American Housing Rescue and Foreclosure Prevention Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

The Court need not speculate about the real-world impact that affirmance of the decisions below would have on the mortgage industry. That analysis has essentially been conducted already by a team of economists led by the Federal Reserve's Wenli Li. Covering a period between the late 1980s and the early 1990s, Li et al. analyzed every court decision concerning mortgage strip-down in the Chapter 7 or Chapter 13 context, at all jurisdictional levels (bankruptcy, district, circuit and Supreme Court).[12] Their aim was to

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[11] *See* Wenli Li, et al., *Using Bankruptcy to Reduce Foreclosures: Does Strip-Down Mortgages Affect the Supply of Mortgage Credit?* (Nov. 24, 2014) 2-3, *available at* http://faculty.som.yale.edu/ishanitewari/documents/LTW_Nov24_2014.pdf.

[12] While Li et al.'s analysis was focused on strip-down and not strip-off, that is a distinction without a difference in this case, as the policy implications of their findings are the same under either scenario. Li et al., at 20 ("Although our results are for mortgages generally rather than second mortgages in particular, they suggest that allowing strip-off of totally underwater second

assess the impact that each decision had on the mortgage market within the geographic jurisdiction covered by that decision. Utilizing sophisticated statistical regression methods, they concluded that the ratification of mortgage strip-down under Chapter 7 "would *not* have strong adverse effects on mortgage loan terms and could be a useful new policy tool to reduce foreclosures" during times of housing market stress.[13] Lien stripping would be advantageous to the millions of homeowners with underwater mortgages because it would reduce their risk of facing default and foreclosure.

Importantly, the economists also found that the benefits of lien stripping do not accrue solely to debtors but can also apply to lenders. Their data analysis revealed that "mortgage strip-down under Chapter 7 did not reduce lenders' profits." Li et al., at 14. Lenders would not be harmed because lien stripping would yield them approximately the same revenue as an immediate foreclosure would. At the time same, lenders would benefit from avoiding the costs and delays associated with the foreclosure process. These findings indicate

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mortgages would not substantially harm future mortgage applicants.").

[13] Li et al., at 4. In fact, the study found that the *Dewsnup* decision *actually produced a 1.5% reduction* in the rate of mortgage approvals in the country. *Id.* That is, history has shown that *Dewsnup* served to hamper "the flow of capital into the home lending market," even though the legislative history behind the Bankruptcy Code reveals a strong preference for facilitating home ownership. *See Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993) (Stevens, J., concurring). The Court would once again run afoul of this vital Congressional objective if it were to extend *Dewsnup*'s reasoning to completely underwater second liens.

that expanded lien voidance under § 506(d) would greatly benefit debtors and the broader economy, while concomitantly leaving lenders' profits relatively unscathed. Significantly, neither the Petitioner nor their amici have submitted any countervailing empirical analysis suggesting that affirmance in this case would have adverse impacts on the mortgage industry.

D. The Court Should Affirm In Light of the Banking Industry's Role In Producing the Mortgage Crisis

Since the housing bubble burst a few years ago, a whopping eight million families have either entered foreclosure or have fallen behind on mortgage payments. FCIC Report at 402. When all is said and done, the crisis is expected to have caused up to thirteen million foreclosures. *Id.* And over 1.4 million households declared bankruptcy in the year 2009 alone. *Id.* at 394. Lenders like the Petitioner have had more than a passing role in bringing about these terrific market conditions.

The bipartisan Financial Crisis Inquiry Commission found banks to be complicit in producing the Great Recession of 2008, a financial catastrophe that saw the extinguishment of 40% of median family wealth from 2007 to 2010. Jesse Bricker, et al., *Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances* 17, Federal Reserve Bulletin (June 2012). Crucially, the FCIC found that "[l]enders made loans *that they knew borrowers could not afford.*" FCIC Report at xxii (emphasis added). During this time, "irresponsible lending, including predatory and fraudulent practices, became more

prevalent." *Id.* at xxiii. Many banks relaxed eligibility standards to unreasonably low levels, often with the objective of luring disadvantaged borrowers into unsustainable subprime mortgages. *Id.* at xxii, 78. The prime objective was "churn[ing] out riskier and riskier loans" to pursue profit at any cost. *Id.* at xx.

Mortgages like the ones at issue in this case supplied the grist for the gargantuan securitization mills run by the nation's largest banks, which repackaged these mortgages into asset-backed securities and related derivatives. When the housing market crashed, the concomitant failure of these esoteric financial products produced cascading losses that reverberated throughout the global financial system. *Id.* at xxv.

One of the chief culprits in the mortgage crisis was Countrywide, which was subsumed into the Petitioner, Bank of America, in 2008:

> As early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in "catastrophic consequences." Less than a year later, they noted that certain high-risk loans they were making could result not only in foreclosures but also in "financial and reputational catastrophe" for the firm. But they did not stop.

Id. at xxii. The FCIC noted similar mismanagement at Bank of America itself.[14] It borders on unseemly and

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[14] *Id.* at 162 ("Similarly, in examining Bank of America in 2007, its lead bank regulator, the Office of the Comptroller of the Currency (OCC), sampled 50 mortgages and found 16 with 'quality

beyond ironic that Bank of America now seeks to paint the Respondents as unworthy recipients of a potential "windfall." Pet. Br. 22.

By filing numerous writs of certiorari on the issue before this Court, the Petitioner has demonstrated its firm commitment to ensuring that underwater debtors facing foreclosure are deprived of a truly unencumbered fresh start via Chapter 7 bankruptcy protection. The Petitioner seeks judicial preservation of its presently valueless second liens so that it may extract every last penny of speculative post-petition collateral value from Chapter 7 debtors. However, this Supreme Court has long recognized its reluctance to vindicate the legal claims of parties with unclean hands:

> [W]henever a party who, as actor, seeks to set the judicial machinery in motion and obtain some remedy, has violated conscience, or good faith, or other equitable principle, in his prior conduct, then the doors of the court will be shut against him in limine; the court will refuse to interfere on his behalf, to acknowledge his right, or to award him any remedy.

Keystone Driller Co. v. Gen. Excavator Co., 290 U.S. 240, 245 (1933) (internal citation omitted).

The Court should refuse to countenance the Petitioner's arguments given the banking industry's role in contributing to the financial difficulties of underwater debtors like the Respondents.

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assurance referrals' for suspicious activity for which no report had been filed with [the concerned oversight bureau.]").

CONCLUSION

For the foregoing reasons, OSEC, as *amicus curiae*, urges the Court to rule in favor of the Respondents and hold that the Eleventh Circuit correctly construed § 506(d) to permit a Chapter 7 debtor to strip-off a junior mortgage lien in its entirety when the outstanding debt owed to a senior lienholder exceeds the current value of the collateral.

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Respectfully submitted,

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